The Economist

MAY 9TH–15TH 2009

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The first great ghost hunter

Europe's new pecking order

Print edition May 9th 2009

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Politics this week

May 7th 2009
From The Economist print edition

AFP

To **Russia's** fury, NATO staged a modest military exercise in **Georgia**. Russia's president, Dmitry Medvedev, called this an "overt provocation". Earlier the Georgian army had put down a mutiny by a tank battalion. And protesters clashed with police in Tbilisi. See article

Gunmen killed 44 people at a wedding party in south-east **Turkey**. Some claimed the assailants were from a militia that had helped Turkish troops fight Kurdish separatists.

The **Czech** Senate voted to approve the European Union's Lisbon treaty, but the Czech president, Vaclav Klaus, said he would not sign it until Ireland decides whether to ratify it. Lech Kaczynski, the Polish president, is taking a similar line. The Irish are expected to hold a second referendum in October.

Kosovo, the former province of Serbia whose independence is recognised by only a few dozen countries, said it had accumulated enough votes to join the International Monetary Fund. Saudi Arabia recently became the first big Muslim country to recognise it.

Trouble at the top

Nepal's Maoist prime minister, Pushpa Kamal Dahal, better known as Prachanda, resigned, raising doubts about a three-year-old peace settlement in the country's civil war. He was protesting against the president's reinstatement of the army chief, whom Mr Dahal had tried to sack for refusing to accept soldiers from the Maoists' former army into the ranks of the army proper. A day later a group of other political parties agreed to form a "national government". See article

Tens of thousands of people fled the Swat valley in north-west **Pakistan** as a peace agreement between the government and local Taliban militants fell apart. Pakistan's president, Asif Zardari, flew to Washington for talks with Barack Obama and his Afghan counterpart, Hamid Karzai. See article

Mr Karzai registered as a candidate for **Afghanistan's** presidential election, due in August. He disappointed Western sympathisers by naming a civil-war era strongman, Mohammad Fahim, as one of his running-mates. See article

Hillary Clinton, America's secretary of state, said her country deeply regretted the deaths of **Afghan civilians** in an air strike in the western Farah province. The Red Cross said dozens had died.

Antasari Azhar, the head of **Indonesia's** anti-corruption agency, was arrested as a suspect in the murder of a prominent businessman killed in a drive-by shooting in March. See article

Australia published its first defence white paper since 2000. It envisaged a big boost in weapons purchases for the navy and air force, estimated to cost some $75 billion. See article

On the mend?

AFP

Mexico's government began to reopen schools and lift restrictions on businesses, after a five-day shutdown, as panic over **swine flu** abated. At least 42 Mexicans were officially confirmed as having died of the bug. A second person died in the United States. Worldwide, confirmed cases rose to almost 1,400 in more than 23 countries. Four schools were temporarily

closed in Britain and China quarantined over 70 Mexicans and 22 Canadian students, prompting protests from those countries. See article

Ricardo Martinelli, a supermarket magnate running as a centrist independent, easily won **Panama's** presidential election. His victory bucked a recent drift to the left in Latin America. See article

Canada and the **European Union** began discussing a free-trade agreement. Nobody seemed to have told the European Parliament, which voted to ban imports of seal products in protest at the annual cull of several hundred thousand young seals in Canada. See article

Venezuela's national assembly gave preliminary approval to a law that would allow President Hugo Chávez's government to seize control of some oil-service companies. Faced with a steep fall in its revenues, PDVSA, the state-owned oil company, wants to cut its costs. See article

Meet the new boss

Jacob Zuma, leader of **South Africa's** ruling African National Congress (ANC), was formally elected the country's president by members of Parliament on May 6th and was due to be inaugurated on May 9th. His party won a landslide victory in a general election on April 22nd.

In **Zimbabwe** 18 political and human-rights campaigners, including members of Morgan Tsvangirai's Movement for Democratic Change, which is in an awkward coalition with President Robert Mugabe's Zanu-PF party, were again released on bail. They had been briefly sent back to prison despite being allowed out on bail in March. The episode highlighted the fragility of the unity government.

In an apparent effort to narrow his differences with the American administration, **Israel's** new prime minister, Binyamin Netanyahu, said he would resume negotiations with the **Palestinians**, though he has yet to agree with Barack Obama's statement that the Palestinians should have a state of their own.

Egypt's government ordered all the country's 250,000 pigs slaughtered in response to the outbreak of swine flu, even though the disease has not yet reached Egypt and international health officials say eating properly cooked pork is safe. That upset the country's 6m-plus Coptic Christians, who own most of the pigs. See article

AFP

Supreme no more

David Souter announced his retirement from America's **Supreme Court**, and will step down when the court's term ends in June. Justice Souter was appointed by George Bush senior in 1990, but generally sided with the court's liberal contingent. Barack Obama is widely expected to nominate a woman as Justice Souter's replacement. See article

The city council of Washington, DC voted to recognise **gay marriages** performed in other states. Congress has 30 days to decide whether to prevent the measure from becoming law. Meanwhile, Maine's governor signed into law a bill that legalises same-sex marriage in the state.

Tributes were paid to **Jack Kemp**, who died at 73. A former quarterback with the Buffalo Bills, Mr Kemp entered politics in the 1970s and became influential within Reagan circles for his support of tax-cutting, supply-side economics. He was Bob Dole's vice-presidential running-mate in 1996. See article

Business this week

May 7th 2009
From The Economist print edition

Sergio Marchionne, the boss of **Fiat**, said that he wanted to buy the European division of **General Motors**, owner of the Opel and Vauxhall brands. The purchase would be in addition to Fiat's proposed takeover of **Chrysler**, which declared itself bankrupt on April 30th. If both deals succeed, they will create one of the world's biggest carmakers, with sales of roughly 6m vehicles a year and revenues of $100 billion. But the plan faces several obstacles, including a possible rival bid for Opel and objections from unions and politicians worried about job losses. See article

Amid a row among their controlling families, **Volkswagen** agreed to merge with **Porsche**, ending a three-year saga. The details are to be worked out in the coming weeks.

Tata Motors said it had received 203,000 advance orders for its tiny **Nano** car, all with big deposits. It will conduct a lottery to determine which customers will receive the vehicle first, as the firm can produce only 60,000 units a year until a new factory opens.

It was a bad week for **telecoms firms**. Alcatel-Lucent, an equipment-maker, announced a loss of €402m ($536m) for the three months to March, compared with a loss of €181m in the same period a year earlier. Profits for the quarter at its rival, Ericsson, fell to SKr1.8 billion ($223m) from SKr2.6 billion a year ago. Motorola, another equipment-maker, posted a loss of $231m.

Stress relief

America's largest banks learnt how they did in the government's stress tests. Hopes rose in advance of the publication of the results that banks with a capital shortfall could close the gap by tapping private capital, selling assets and converting the government's preferred shares into common equity. Meanwhile, the Federal Reserve's latest loan-officer survey showed that American banks continued to tighten lending standards in the three months to April, although not quite as sharply as before. See article

Elsewhere, banks reported mixed first-quarter results. **BNP Paribas** and **Barclays** made strong profits, thanks largely to buoyant revenues in their investment banks. **Standard Chartered**, an emerging-markets lender, announced record profits for the quarter thanks to its wholesale division. **Société Générale** announced a loss after more big write-downs and rising loss provisions. **UBS** struggled, as the Swiss bank confirmed another hefty loss and continued to lose clients.

The European Union said the **recession in Europe** would be worse than it had initially projected. It now expects a contraction of 4% this year, more than twice its previous estimate. It also predicted a further decline in 2010, with unemployment rising to 11%. See article

The Institute for Supply Management's latest monthly survey suggested that both **services** and **manufacturing** shrank at a slower rate in America than they had in previous months. The same trend was evident in Britain and the euro zone.

This news helped to push the **oil price** to its highest point this year, above $56 a barrel. But it remains far below the peak it attained last year, of almost $150.

V-shaped recovery

Stockmarkets also rose. The S&P 500 index of American shares closed above 900 on May 4th, regaining all its losses for the year to date. Investors have been encouraged by signs that the global recession might not be as deep as feared and by better-than-expected first-quarter results for many firms.

Barack Obama said that he wanted to curtail **tax avoidance** by American firms with overseas operations. The president's proposal to scrap various tax breaks, which must be approved by Congress, prompted an outcry from multinationals and concern from countries such as Ireland that have low corporate-tax rates. See article

The European Central Bank cut its main policy interest rate by a quarter of a percentage point, to 1%, as expected. The Bank of England held its rate at 0.5% but expanded its programme of "quantitative easing". It said it would increase its bond purchases financed by new central-bank reserves from £75 billion ($113 billion) to £125 billion.

Double trouble

An American regulator, the Federal Trade Commission, was reported to be investigating whether the overlap between the boards of **Apple** and **Google** violates antitrust laws. Eric Schmidt, Google's chief executive, and Arthur Levinson, a former boss of Genentech, a biotech company, sit on the boards of both firms. If the FTC finds that this limits competition in the markets the companies have in common, such as web browsers or word processing, it could force the two men to resign. See article

KAL's cartoon

May 7th 2009
From The Economist print edition

Illustration by KAL

Economist.com OPINION LEADERS

Europe's economies

A new pecking order

May 7th 2009
From The Economist print edition

There has been a change in Europe's balance of economic power; but don't expect it to last for long

AFP

FOR years leaders in continental Europe have been told by the Americans, the British and even this newspaper that their economies are sclerotic, overregulated and too state-dominated, and that to prosper in true Anglo-Saxon style they need a dose of free-market reform. But the global economic meltdown has given them the satisfying triple whammy of exposing the risks in deregulation, giving the state a more important role and (best of all) laying low *les Anglo-Saxons*.

At the April G20 summit in London, France's Nicolas Sarkozy and Germany's Angela Merkel stood shoulder-to-shoulder to insist pointedly that this recession was not of their making. Ms Merkel has never been a particular fan of Wall Street. But the rhetorical lead has been grabbed by Mr Sarkozy. The man who once wanted to make Paris more like London now declares laissez-faire a broken system. Jean-Baptiste Colbert once again reigns in Paris. Rather than challenge *dirigisme*, the British and Americans are busy following it: Gordon Brown is ushering in new financial rules and higher taxes, and Barack Obama is suggesting that America could copy some things from France, to the consternation of his more conservative countrymen. Indeed, a new European pecking order has emerged, with statist France on top, corporatist Germany in the middle and poor old liberal Britain floored.

A cockpit of competing capitalisms

It is easy to dismiss this as political opportunism. But behind it sits a big debate not only about the direction of the European Union, the world's biggest economic unit, but also about what sort of economy works best in the modern world. Thirty years after Thatcherism began to work its cruel magic in Britain (see article), continental Europe still tends to favour a larger state, higher taxes, heavier regulation of product and labour markets and a more generous social safety-net than freer-market sorts like the Iron Lady would tolerate. So what is the evidence for the continental model being better?

The continental countries certainly have not escaped the recession: France may be doing a bit better than the world's other big rich economies this year, but Germany, dragged down by its exporting industries, is doing significantly worse. Yet Mr Obama is right to admit that in some ways continental Europe has coped well. Tough job-protection laws have slowed the rise in unemployment. Generous welfare states have protected those who are always the first to suffer in a downturn from an immediate

sharp drop in their incomes and acted as part of the "automatic stabilisers" that expand budget deficits when consumer spending shrinks. In Britain, and to an even greater extent in America, people have felt more exposed.

The downturn has also confirmed that the continental model has some strengths. France has a comparatively efficient public sector, thanks in part to years of investment in better roads, more high-speed trains, nuclear energy and even the restoration of old cathedrals (see article). Nor is it just a matter of pumping in ever more taxpayers' cash. By any measure France's health system delivers better value for money than America's costlier one. Germany has not just looked after its public finances more prudently than others; its export-driven model has forced its companies to hold down costs, making them competitive not only in Europe but also globally. By design as well as luck, much of continental Europe avoided the debt-fuelled housing bubbles that popped spectacularly in Britain and America (though Spain did not, see article).

But will it last? The strengths that have made parts of continental Europe relatively resilient in recession could quickly emerge as weaknesses in a recovery. For there is a price to pay for more security and greater job protection: a slowness to adjust and innovate that means, in the long run, less growth. The rules against firing that stave off sharp rises in unemployment may mean that fewer jobs are created in new industries. Those generous welfare states that preserve people's incomes tend to blunt incentives to take new work. That large state, which helps to sustain demand in hard times, becomes a drag on dynamic new firms when growth resumes. The latest forecasts are that the United States and Britain could rebound from recession faster than most of continental Europe.

Individual countries have specific failings of their own. Even if it did everything else right, Germany's overreliance on exports at the expense of consumer spending has proved a grave weakness in a downturn (see article); its banks also look weak. The rate of youth unemployment in France is over 20% and it can be twice as high in the notorious *banlieues* where Muslim populations are concentrated. Italy and Spain have seen sharp rises in unit labour costs and their labour-productivity growth has stalled or gone into reverse. It may not be long before the fickle Mr Sarkozy is re-reading his Adam Smith.

Not what you aim for, but how you do it

If there is to be an argument about which model is best, then this newspaper stands firmly on the side of the liberal Anglo-Saxon model—not least because it leaves more power in the hands of individuals rather than the state. But the truth is that the governments on both sides of the intellectual divide could go a long way to making their models work better, without changing their underlying beliefs.

On the continental side, there is nothing especially socially cohesive about labour laws that favour insiders over outsiders, or rules that make the costs of starting a business excessive. Even Colbert might admit that Europe's tax burdens are too onerous today, particularly since they are likely to have to rise in the future to meet the looming cost of the continent's rapidly ageing populations.

For the liberals, even if the cycle swings back in their direction, the financial crisis and the recession have shown up defects in the way they too implemented their model. Getting regulation right matters as much as freeing up markets; an efficient public sector may count as much as an efficient private one; public investment in transport, schools and health care, done well, can pay dividends. The pecking order may change, but pragmatism and efficiency will always count.

Barack Obama and the carmakers

An offer you can't refuse

May 7th 2009
From The Economist print edition

In its rush to save Detroit, the American government is trashing creditors' rights

Illustration by Claudio Munoz

NO ONE who lent money to General Motors (GM) or Chrysler can have been unaware of their dire finances. Nor can workers have failed to notice their employers' precarious futures. These were firms that barely stayed afloat in the boom and both creditors and employees were taking a punt on their promise to pay debts and generous health-care benefits.

The bet has failed. The recession has tipped both firms into the abyss—together they lost $48 billion last year. Chrysler has entered bankruptcy, from which it may emerge under Fiat's control (see article). GM could soon follow if efforts to hammer out a voluntary restructuring fail. America's government, keen to protect workers, is providing taxpayers' cash to keep the lights on at both firms. But in its haste it has vilified creditors and ridden roughshod over their legitimate claims over the carmakers' assets. At a time when many businesses must raise new borrowing to survive, that is a big mistake.

Bankruptcies involve dividing a shrunken pie. But not all claims are equal: some lenders provide cheaper funds to firms in return for a more secure claim over the assets should things go wrong. They rank above other stakeholders, including shareholders and employees. This principle is now being trashed. On April 30th, after the failure of negotiations, Chrysler entered Chapter 11. Under the proposed scheme, secured creditors owed some $7 billion will recover 28 cents per dollar. Yet an employee health-care trust, operated at arm's length by the United Auto Workers union, which ranks lower down the capital structure, will receive 43 cents on its $11 billion-odd of claims, as well as a majority stake in the restructured firm.

The many creditors who have acquiesced include banks that themselves rely on the government's purse. The objectors have been denounced as "speculators" by Barack Obama. The judge overseeing the case has consented to a quick, "prepackaged" bankruptcy, which seems to give little scope for creditors to argue their case or pursue the alternative of liquidating the company's assets. In effect Chrysler and the government have overridden the legal pecking order to put workers' health-care benefits above more senior creditors' claims, and then successfully argued in court that the alternative would be so much worse for creditors that it cannot be seriously considered.

The Treasury has also put a gun to the heads of GM's lenders. Unsecured creditors owed about $27 billion are being asked to accept a recovery rate of 5 cents, says Barclays Capital, whereas the health-care trust, which ranks equal to them, gets 50 cents as well as a big stake in the restructured firm. If creditors refuse to co-operate, the government will probably seek to squash them using the same fast-track legal process.

Chapter and verse

The collapse of Detroit's giants is a tragedy, affecting tens of thousands of current and former workers. But the best way to offer them support is directly, not by gerrymandering the rules. The investors in these firms are easily portrayed as vultures, but many are entrusted with the savings of ordinary people, and in any case all have a legal claim that entitles them to due process. In a crisis it is easy to put politics first, but if lenders fear their rights will be abused, other firms will find it more expensive to borrow, especially if they have unionised workforces that are seen to be friendly with the government.

It may be too late for Chrysler's secured creditors and if GM's lenders cannot reach a voluntary agreement, they may face a similar fate. That would establish a terrible precedent. Bankruptcy exists to sort legal claims on assets. If it becomes a tool of social policy, who will then lend to struggling firms in which the government has a political interest?

Economist.com OPINION LEADERS

Nepal's political crisis

Two armies into one won't go

May 7th 2009
From The Economist print edition

With peace in its grasp, Nepal is let down by its politicians and its army

Reuters

TO MUCH of the outside world, Nepal has seemed blissfully quiet in recent months. The peace process that ended a bloody ten-year civil war in 2006 seemed on track, and outsiders could go back to seeing the place as a small Himalayan holiday-spot of little concern.

But Nepal is neither insignificant nor irrelevant. It has nearly 30m people and occupies a strategic position between Asia's emerging giants, India and China. And the notion that its divisions were healed was an illusion that has been shattered by a bust-up between the prime minister and the army (see article). The country now faces a crisis for which the Maoists, the other parties and the army all share responsibility. So do Nepal's foreign partners, especially the most important one, India.

It was a jolt to most foreign observers and the Nepali elite when Maoist insurgents won the most seats in an election a year ago. The shock eased as the rebels swapped combat fatigues for lounge suits, put on weight and started to resemble normal grasping politicians. Just as in peace processes from Northern Ireland to Sri Lanka, however, Nepal's politicians left the hardest parts to last.

The deferred, intractable issue is the future of Nepal's security forces. What was once the "Royal" Nepal Army, which propped up the now deposed king, Gyanendra, in a short-lived dictatorship, has been refusing to follow the writ of the government of the new republic, led by the Maoist leader, Pushpa Kamal Dahal, better known by his *nom de guerre*, Prachanda. Under the peace agreement, the Maoists' ragtag bunch of guerrillas was supposed to be integrated with the proper army.

The army will have nothing of it, so former Maoist fighters are still holed up in United Nations-supervised cantonments. Mr Dahal sacked the army chief. The president reinstated him, so the prime minister has now resigned.

The Maoists have, in part, themselves to blame for making the army—and everyone else—nervous about their commitment to pluralism. Although they have confounded fears that they would be a Nepali, elected Khmer Rouge, they still talk (amongst themselves, at least) about a totalitarian-sounding "people's republic". Their youth wing is guilty of thuggery. Yet, whatever their private ambitions, Mr Dahal has offered to join a government of national unity if the president rescinds his reinstatement of the army chief. That seems the least bad outcome. But it relies on the acquiescence of the other political parties and the army, who have seemed even more hostile than do the Maoists to the peace deal they all struck.

In last year's election the Maoists won 38% of the seats in a Constituent Assembly. The other, losing, parties came out in support of the sacked army commander and seemed ready, with army backing, to form a government without the Maoists. The former rebels thus captured the democratic high ground.

And to do its job—drafting a constitution—the assembly needs the Maoists, who have a blocking vote.

Delhi dallying

Nepal's foreign donors should have pushed harder for the establishment of proper civilian control over the army. India, which did much to engineer the peace, has quietly backed the army commander's unconstitutional disobedience. The Delhi government sees the army as its truest friend in Nepal, where it has long had an overweening influence. Facing a large, scattered Maoist rebellion of its own, India has also been alarmed by the Nepali Maoists' rapprochement with China (which had no time for them when they were mere leftist guerrillas).

In standing down, Mr Dahal has been able to present himself as both a champion of the poor, and defender of Nepali pride against a meddling neighbour. The Maoists' prestige may be further bolstered in coming months by their having quit government at a time of mounting economic hardship and disillusionment with the peace process. All this may strengthen them. Eventually, India and other powers will have to accept that the Maoists are in Nepali politics for the long haul.

Deflation in America

The greater of two evils

May 7th 2009
From The Economist print edition

Inflation is bad, but deflation is worse

MERLE HAZARD, an unusually satirical country and western crooner, has captured monetary confusion better than anyone else. "Inflation or deflation," he warbles, "tell me if you can: will we become Zimbabwe or will we be Japan?"

How do you guard against both the deflationary forces of America's worst recession since the 1930s and the vigorous response of the Federal Reserve, which has in effect cut interest rates to zero and rapidly expanded its balance-sheet? On May 4th Paul Krugman, a Nobel laureate in economics, gave warning that Japan-style deflation loomed, even as Allan Meltzer, an eminent Fed historian, foresaw a repeat of 1970s inflation—both on the same page of the *New York Times*.

There is something to both fears. But inflation is distant and containable, while deflation is at hand and pernicious.

Dragged down by debt

Fears about deflation do not rest on the 0.4% decline in American consumer prices in the year to March. Although this is the first such annual decline since 1955, it is the transitory result of a plunge in energy prices. Excluding food and energy, core inflation is 1.8%. Rather, the worry is of persistent price declines that characterise true deflation. With unemployment nearing 9%, economic output is further below the economy's potential than at any time since 1982. This gap is likely to widen. House prices are not part of America's inflation index but their decline is forcing households to reduce debt (see article), which could subdue economic growth for years. As workers compete for scarce jobs and firms underbid each other for sales, wages and prices will come under pressure.

So far, expectations of inflation remain stable: that sentiment is itself a welcome bulwark against deflation. But pay freezes and wage cuts may soon change people's minds. In one poll, more than a third of respondents said they or someone in their household had suffered a cut in pay or hours. The employment-cost index rose by just 2.1% in the year to the first quarter, the least since records began in 1982. In 2003, during the last deflation scare, total pay grew by almost 4%.

Does this matter? If prices are falling because of advancing productivity, as at the end of the 19th century, it is a sign of progress, not economic collapse. Today, though, deflation is more likely to resemble the malign 1930s sort than that earlier benign variety, because demand is weak and households and firms are burdened by debt. In deflation the nominal value of debts remains fixed even as nominal wages, prices and profits fall. Real debt burdens therefore rise, causing borrowers to cut spending to service their debts or to default. That undermines the financial system and deepens the recession.

From 1929 to 1933 prices fell by 27%. This time central banks are on the case. In America, Britain, Japan and Switzerland they have pushed short-term interest rates to, or close to, zero and vastly expanded their balance-sheets by buying debt. It helps, too, that the world has abandoned the monetary straitjacket of the gold standard it wore in the 1930s.

Yet this anti-deflationary zeal is precisely what alarms people like Mr Meltzer. He worries that the price of seeing off deflation is that the Fed will be unable or unwilling to reverse itself in time to prevent a resurgence of inflation.

Fair enough, but inflation is easier to put right than deflation. A central bank can raise interest rates as high as it wants to suppress inflation, but it cannot cut nominal rates below zero. Deflation robs a central bank of its ability to stimulate spending using negative real interest rates. In the worst case, rising debts and defaults depress growth, poisoning the economy by deepening deflation and pressing real interest rates higher. Central banks that have lowered rates to nearly zero are now using unconventional, quantitative tools, but their efficacy is unproven. Given the choice, erring on the side of inflation would be less catastrophic than erring on the side of deflation.

That said, there is a legitimate concern that when the time comes to raise interest rates, the Fed may hold back because of political pressure or fear of fracturing financial markets. The Fed was too slow to raise interest rates after its deflation scare in 2003. Yet that is best addressed by strengthening the Fed. Barack Obama should nominate credible, independent people to the two vacant seats on the Federal Reserve Board, and bat away suggestions that the 12 reserve-bank presidents, who are not confirmed by Congress, lose their say in monetary policy. Congress should let the Fed issue its own debt, which would give it scope to tighten monetary policy without disorderly sales of the illiquid private debt it has taken on.

Affirming the Fed’s political independence and equipping it with better tools would help the central bank combat inflation when the time comes. It would also lessen the risk that it tightens prematurely just to demonstrate its resolve.

Animal welfare

Catheter and mouse

May 7th 2009
From The Economist print edition

Sharing information on failed animal experiments would help both scientists and rats

Rex Features

IN AN ideal world, people would not test medicines on animals. Such experiments are stressful and sometimes painful for animals, and expensive and time-consuming for people. Yet there are vast gaps in medical knowledge which animal experimentation can help close. People have power over animals, so they use animals to help their own species.

Yet the notion that animal suffering is pitted against human welfare—animal pain against human gain—is too stark. After all, it is in scientists' interests to treat animals well. If laboratory animals are properly looked after, differences in experimental results are more likely to be down to the science than to the guinea-pigs' health. Sometimes, numbing animals' pain makes sense, too. Research has shown that giving pain-relieving drugs to animals that are undergoing experimental surgery may enhance the results, by making the animal's experience more like a person's. And some changes in the regulation of scientific research, proposed by the European Commission on May 5th, should further reduce animal suffering and at the same time produce better science.

Murine morals

Between 50m and 100m animals are used in research each year around the world, says the Nuffield Council on Bioethics, a British think-tank. Europe has the world's most restrictive laws on animal experiments. Even so its scientists use some 12m animals a year, most of them mice and rats, for medical research. That number has been creeping up, mainly because scientists can now plant foreign genes into creatures so that they better mimic human responses to disease.

At first sight American animal experimentation appears modest by comparison. Official statistics show that just 1.1m animals are used in research each year. But that is misleading. The American authorities do not think mice and rats are worth counting and, as these are the commonest laboratory animals, the true figure is much higher. Japan and China have less comprehensive data even than America. Animals used in research there are not protected as they are in the West. Nevertheless, academic centres promoting alternatives to animal testing have grown up in both places in recent years.

Now Europe is reforming the rules governing animal experiments (see article). At first sight, the law seems like just another piece of European bureaucracy: slow and onerous. Although the proposed directive has just been approved in draft by MEPs, it is still some years from becoming law. But the law has two decent aims: to encourage alternatives to animal testing such as using human tissue or computer models, and to ensure the welfare of laboratory animals.

Replacing animal experiments with alternatives is a good idea on several counts. Animal studies can sometimes be of dubious scientific value, since different species react differently to the same procedure. It is also easier to standardise results if you do not depend on individual animals. Sadly, international agreements on the sale of medical treatments limit the use of alternatives. On April 27th America, Canada, Europe and Japan promised to co-operate on validating alternatives to animal testing. The EU law is another step forward.

But the greatest gain, whether you have four legs or two, should come from the commission's proposal that scientists who use animals should share data (subject to confidentiality). At present, scientists often share only the results of successful experiments. If their findings do not fit the hypothesis being tested, the work never sees the light of day. This practice condemns others who have the same idea to waste time, money and animals' lives in duplicating the failed experiment. Some duplication would still occur: repeating experiments that produce positive results to check that they really are as good as they say is necessary. So is replicating negative results to check that they are, indeed, negative. But endlessly rerunning failed experiments helps nobody.

Animal experimentation has taught humanity a great deal and saved countless lives. It needs to continue, even if that means animals sometimes suffer. Europe's new law should eventually both lessen that pain and improve the way in which science itself is done. Other regulators should copy it.

On water, Cyprus and Turkey, China and currencies, the Summit of the Americas, Barack Obama, defence spending, casinos

May 7th 2009
From The Economist print edition

The water margin

SIR – You are sceptical about the feasibility of scarcity pricing for water, but your support of tradable rights for water use is hardly more practical ("Sin aqua non", April 11th). Contrary to what you state, the development of these markets does depend on secure legal title to the water and the ability to accurately measure the volumes traded. Trades in water have emerged in a few regions where conditions are propitious and in parts of the Indian subcontinent where farmers have surplus groundwater, but their global scale is marginal and their potential is likely to remain limited.

Markets will drive change in other ways, signalling scarcity and producing the required adjustments to farmers' behaviour. Growing city populations can normally outbid farmers' demand for water and buy their land and the permanent water rights that go with it. Farmers adjust by shifting to higher-value crops in demand from the cities, and make more efficient use of scarcer and more valuable water. As scarcity grows, there will be increasing demand for valuable supplementary irrigation water, supplied by private concessionaires or by landowners who sell their water, rather than their crops. "Virtual water" will come to the rescue as lower value crops such as cereals will increasingly be imported from regions where water is more plentiful.

James Winpenny
Wychwood Economic Consulting
Chipping Norton, Oxford

SIR – In the Columbia river drainage area, where water supply is immense, the empty-gesture environmentalist politics of federal and state agencies does not allow for any new water rights (or incremental usage) even when tied to highly efficient uses. These agencies usually reject sound tenets of water-resource economics. If cogent economic principles are despised in this relatively blessed and supposedly intelligent corner of the world, it is doubtful that reliance on water rights will survive more politically ruthless or less-capable governments.

Darryll Olsen
Resource economist
Columbia-Snake River Irrigators Association
Kennewick, Washington

SIR – One sentence in your article struck me as singularly wrong-headed: "The shift of diet will be impossible to reverse since it is a product of rising wealth and urbanisation." Given the burden on health from an inordinately meat-based diet, the contribution that beef production makes to climate change, and the extraordinary toxic soup of pesticides, steroids and antibiotics that are increasingly used in the production of meat, one assumes that societies around the world will choose a different path to "affluence".

William Hewitt
New York

Cyprus and Turkey

SIR – Your article on the "elections" in the occupied part of Cyprus showed more concern for Turkey's accession to the European Union than for negotiations over the reunification of Cyprus ("A hawkish problem", April 25th). In 2005 Turkey undertook to fulfil a number of obligations. Its refusal to open to Cypriot ships and aircraft harms the normalisation of relations with Cyprus and is an obstacle to free

trade and competition.

Moreover, your reference to “trade restrictions” imposed by the EU on the occupied north is unfounded when what is happening is the application of national, international and European law on trade, customs and sovereign rights of states. In 2004 Cyprus proposed measures aimed at promoting trade with the Turkish Cypriots. These were rejected outright by their leadership. The suggestion that Cyprus has tried to “subvert” Turkey’s EU membership is equally unfounded. In 2005, Cyprus decided to support the beginning of accession negotiations with Turkey, and on April 23rd, the president of Cyprus and the Greek prime minister reiterated their support for Turkey’s membership bid, provided Turkey fulfils the obligations and requirements.

Alexandros Zenon
High commissioner for Cyprus
London

Currencies exchange

SIR – The punchline to your article on China’s foreign-exchange reserves is that “China cannot sour on the dollar without letting its own currency rise” (Economics focus, April 25th). This is not correct. China can continue to hold down the yuan’s exchange rate by buying dollars but then convert those dollars into euros or other hard currencies. The exchange rate between the dollar and the euro would change but the yuan would remain substantially undervalued.

That is why I support Governor Zhou Xiaochuan of the People’s Bank of China’s suggestion of a substitution account at the IMF into which China and other countries could deposit their dollars for Special Drawing Rights (SDRs). The transactions would be completely off-market and thus avoid the exchange-rate consequences of Chinese currency diversification that could otherwise be extremely uncomfortable to the United States and the euro area. This would be a much more modest step than replacing dollars with SDRs as the global key currency. However, it would effectively address the more imminent risk of Chinese dollar conversions that could otherwise roil the financial markets and world economy.

Fred Bergsten
Director
Peterson Institute for International Economics
Washington, DC

Sorry to disappoint

SIR – From a substantive perspective I fail to find anything to support the contention that Barack Obama’s trip to the Summit of the Americas in Trinidad “was a success” (“The charming neighbour”, April 25th). For a summit that was supposed to focus on energy security, where is the commitment to establish a hemispheric free-trade area in conventional and alternative energy resources? No hemispheric cap-and-trade mechanism was even proposed that would satisfy the official agenda item on environmental sustainability. In fact, the visiting heads of state left Port of Spain without even signing a final declaration, thereby avoiding committing their governments to any course of action on anything.

Thomas Andrew O’Keefe
President
Mercosur Consulting Group
Washington, DC

Hearts and minds

SIR – Your article on Barack Obama’s foreign policy cited Machiavelli’s axiom that it is often better to be feared than loved (“Two cheers and a jeer”, April 11th). In fact, Machiavelli said it is better to be loved than feared, but if a prince cannot be effective and loved he should consider being effective and feared. It seems Mr Obama is both effective and loved by most people across the world. He does not have to be feared to be taken seriously.

Alexander Tregub
San Jose, California

The following letter appears online only

SIR – I can only assume that you have subcontracted your coverage of Barack Obama to an editorial team from the Republican National Committee. Give the man a break for God's sake! He has only been in office for three months, during which time he has been quite preoccupied with putting together an executive, saving the American economy from its latest Republican-engineered meltdown, and trying to get a few things done on pressing issues ignored by Congress these past 20 years. Nevertheless, he finds time to flit off overseas to wave the flag a bit and start undoing the damage done by his cretinous predecessor, and the best you can do by way of considered commentary on the trip is Newt Gingrich. Who can we expect next? Rush Limbaugh?

Robert Crooks
Washington, DC

The following letter appears online only

On guard

SIR – The Obama administration's decision to reduce defence spending rests on two false assumptions: that all future wars will be irregular "small wars"; and that you can negotiate successfully with potential enemies ("A daring punt", April 11th). Yet the arms race in Asia isn't showing any signs of slowing. The Chinese, Indians and Russians are spending vast amounts on arming their military forces with conventional weapons. In Georgia, the Russians used conventional military force to achieve political goals. The Chinese desire a conventional blue-water navy to project might. Minor powers are rearming with conventional weapons as well.

The left believes that the world's problems can be solved by simply talking nice. Anyone can negotiate successfully with persons of goodwill, but how do you negotiate with people who are bent on your destruction or subjugation? The best way to break cycles of violence with your implacable enemies is to be prepared to defeat them. As has been said many times: if you want peace, prepare for war.

Scott Rogers
Colorado Springs, Colorado

Place your bets

SIR – The tribulations of MGM Mirage and other big casinos in Las Vegas is heart-wrenching ("Dicing with debt", April 18th). Surely the government must have a bail-out plan to save them? For the sake of economic stability, as for the banks, the country needs institutions where the house always wins.

James Mitchell
Professor of physics
Université de Rennes I
Rennes, France

The French model

Vive la différence!

May 7th 2009 | BEAUVAIS AND PARIS
From The Economist print edition

The French way of doing things looks pretty good—at least in these troubled economic times

Illustration by Matt Herring

OVER 60 metres (nearly 200 feet) above the ground in the Picardy town of Beauvais, fiscal stimulus *à la française* is under way. With tiny paintbrushes and sandblasters, artisans perched on scaffolding are painstakingly scraping away at the damaged façade of the towering 14th-century gothic cathedral. The €2m ($2.7m) restoration is one of 1,000 projects put in place by the French government as part of its €26 billion stimulus plan. Along with more conventional schemes, such as upgrades to motorways, ports and the TGV high-speed train network, France's boost includes the scrubbing up of a host of its historic cathedrals and churches.

Even in a crisis, the French do things differently. Despite calls from the Americans to do more to lift consumer demand, their stimulus plan relies heavily on front-loading investment in infrastructure, cathedrals included, in line with their *dirigiste* tradition. A strong beneficent state, with heavy taxation, regulation and protection, is common to many continental European countries. But nowhere is it more pronounced or entrenched than in France, where it reaches back to the construction of roads, canals and industrial mammoths under Jean-Baptiste Colbert, Louis XIV's minister of finance and industry.

In recent years, before the financial crash, what is loosely known as the French model came in for fierce criticism, chiefly for failing to generate enough growth or jobs. Its detractors have not only been *les Anglo-Saxons* but have also included Nicolas Sarkozy himself. He may be better known now for proclaiming the end of laissez-faire capitalism. But he was elected France's president partly by arguing that the French model was moribund, and picking out the British and American models for praise.

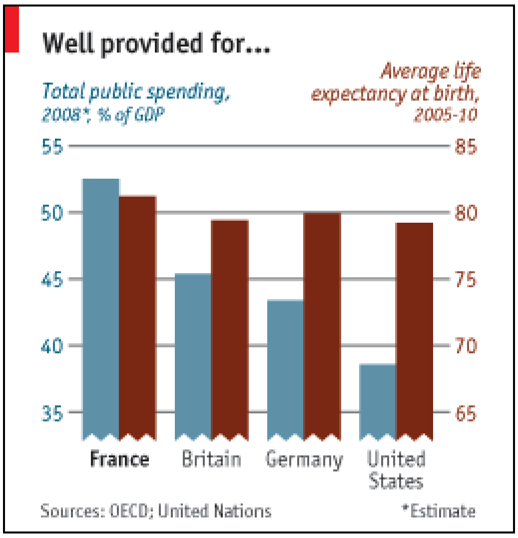
Before him, a string of government-commissioned reports, written by such authors as Michel Camdessus, a former IMF managing director, and Michel Pébereau, chairman of BNP Paribas, laid bare the failings and costs of the system. France's public spending accounted for 52% of GDP in 2007, next to 45% in Britain and 37% in America. Yet in 1997-2007 its annual rate of GDP growth was below the OECD average.

To be sure, the French economy has been battered by the global recession like any other. Firms are cutting output and shedding jobs. Unemployment reached 8.6% in February. There have been regular mass rallies across France in protest at job cuts. More sinisterly, there has been a wave of "boss-napping", a form of kidnapping in which managers are kept by workers overnight in their own offices.

Yet France's economy has been less hard hit than many. Its GDP is expected to shrink by 3% this year,

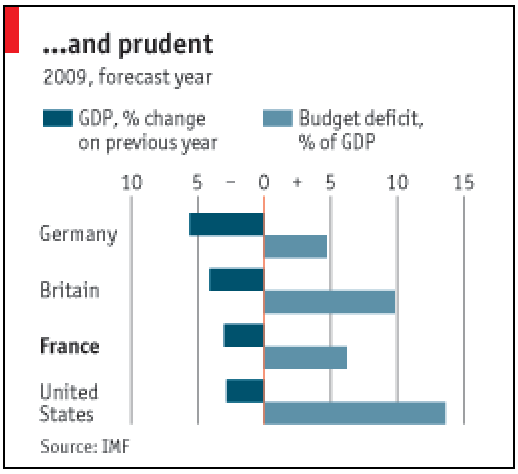
according to the IMF, against 4.1% in Britain, 4.4% in Italy and 5.6% in Germany (see charts). It is less dependent on exports than Germany, and consumer spending in the first quarter of 2009 was up on the same period last year. The government, usually reprimanded for profligacy, is set to have a deficit in 2009 (6.2% of GDP) well below those in America (13.6%) and Britain (9.8%).

The French are great savers and most have not taken out unaffordable mortgages or spent heavily on credit. Household debt as a share of GDP is less than half that in Britain or America. The prospect of nationalising banks may give Americans nightmares about turning French. In fact the French government has not yet had to rescue any big French bank from collapse, let alone nationalise one. Though there is outrage at bonus payments in firms laying off workers, bosses' pay in France is not that extravagant, and the income gap between the top 10% and the bottom 10% is far smaller than in Britain or America.



Indeed, with a mix of amusement and self-satisfaction, the French have watched *les Anglo-Saxons* start to sound, well, increasingly French. Barack Obama says he wants Americans to save more and consume less, to make real things rather than short-term paper profits, to redistribute more wealth and provide health care for all. When he dropped in on Strasbourg, in eastern France, a town now linked by the TGV to Paris in little over two hours, he asked enviously: "Why can't we have high-speed rail?" *Time* ran an article entitled "How we became the United States of France". *Newsweek* published one claiming that "The last model standing is France". When Christine Lagarde, France's finance minister, appeared recently on Jon Stewart's "The Daily Show", an American comedy programme, she joked that "maybe you are moving in our direction."

In Britain, Gordon Brown has declared—like Mr Sarkozy—that "laissez-faire has had its day". Business chiefs clamour for Britain to get itself a proper industrial policy and stop relying on the mirage of finance. Howard Davies, head of the London School of Economics, wrote in praise of "French lessons on the state's new role". Even Peter Mandelson, a former European trade commissioner whom the French regard as a high priest of economic liberalism, recently turned up in Paris to learn more about what he calls industrial activism. "We have something to learn from continental practice," he said, identifying French long-term strategic planning in such sectors as energy and transport.



To French ears, all this is rather pleasing. Mr Sarkozy hailed the G20 London summit as the end of the Anglo-Saxon model of capitalism. *Le Monde*, a leading daily, wrote: "In the crisis, the French model, formerly knocked, finds favour once more."

Croissants and car tyres

Behind the loose terms and caricature, however, what exactly does the French model consist of? Does it work? As governments try to work out the best balance between the market and the state, have the French got that balance right after all?

The low-lying region of Picardy in northern France has been as battered by the global slump as any other. Workers at Continental, a tyre manufacturer, recently trashed an administrative building when the courts upheld the closure of a factory at Clairoix, with the loss of 1,120 jobs—a crushing blow to employees who had agreed to work a longer week in return for a promise to keep the site going. In nearby Beauvais, Bosch closed its factory last year, putting 240 people out of work. Now there are worries about the future of a sponge factory in the town.

Yet at lunchtime on a warm spring day, tables at the pavement cafés in the town centre, near the scaffolding-clad cathedral, are all taken. Municipal flowerbeds, where cornflower-blue lupins nestle next to ornamental cabbages, are well stocked and tended. The car park at the local hypermarket is packed. Traffic at the nearby low-cost airport, a big employer, is still busy. And local electronics and perfume

factories are holding up well. “This is not a rich town,” says Caroline Cayeux, the centre-right mayor. “But having the French social system enables people to keep their heads above water.”

Beauvais, the administrative capital, captures the cushioning effect of the French model in recession, and its strong egalitarian ethos. On the one hand, there is widespread fear of job losses. On the other, there is a sense that the economy is propped up even in bad times by the public sector and the welfare system. Fully 43% of the town’s residents live in rent-subsidised social housing. The town hall itself is a big employer. Some 130 gardeners, for example, toil away in its flowerbeds year-round, digging, weeding and planting. It also distributes all manner of direct help to families, such as vouchers for children’s holidays or after-school activities. It has devised a special scheme for the 4,500 “working poor”, who fall outside other national welfare safety-nets.

Across France, 5.2m workers, or 21% of those with jobs, are employed by the public sector. If you count others whose incomes or jobs are not exposed to the economic cycle, 49% of those either in work or retired are only moderately vulnerable to the recession, according to Xerfi, an economics consultancy. Add to that layers of social protection, including unemployment benefits that can reach up to 75% of previous salary, and a raft of direct payments for families, such as €889.72 for newborn babies, and the French are relatively sheltered from market downturns.

Moreover, France’s health system, a mix of private and public provision, manages both to guarantee universal coverage and produce a relatively healthy population for half the cost per person of America’s, and with shorter waiting lists than Britain’s somewhat cheaper version. The French have higher life expectancy than both the British and Americans. Through means-testing, the state covers those without the top-up private insurance needed to complement the public scheme.

All these “automatic stabilisers”, argues Ms Lagarde, help to support demand and should be counted as part of the fiscal stimulus package. Indeed, the finance ministry has received many recent visits from other governments’ officials interested in the French system. “The difference is that the French model provides shock absorbers that were already in place,” she comments. “We haven’t had to reinvent our unemployment, health or welfare systems.”

A central feature of the French model is the state’s role as provider, cushioning citizens, redistributing wealth and propping up demand in hard times. But it has two other functions: planner and regulator.

The ghost of Colbert

The French finance ministry is housed in a vast modern structure that juts out on pillars into the Seine in eastern Paris. The finance minister also has use of the Hôtel de Seignelay, an elegant 18th-century riverside mansion in the capital’s fashionable heart. Outside the minister’s parquet-floored office stands a fine bust of Colbert, whose grandson lived in the house. Colbertist state planning helped to reconstruct France after the second world war, delivering the *trente glorieuses*, or 30 years of post-war economic growth. Until recently an official “planning commission”, in charge of strategic four-year plans, still operated. The official body has gone, but the spirit, like the bust, lives on.

Long-term planning of public infrastructure is the best example of where it works well. London’s first fast-link cross-city underground line, Crossrail, is not due to open until 2017, but Paris boasts a network of five such RER lines, first launched in the late 1960s. Mr Sarkozy has just unveiled the latest step: a ten-year project to build an automated metro loop around the city outskirts, linking the main airports. France’s TGV network, whose first tracks were laid in 1974 under Georges Pompidou, continues to spread. The construction costs are heavy, with debt now hived off into a separate rail-network entity. Yet with average speeds of 300km per hour (190mph), the trains provide a viable and ecological alternative to air and road travel. Many businessmen use the TGV for daily trips between big French cities.

Or take the nuclear industry. The French government decided to push nuclear power in a big way back in the 1970s, in response to the oil shock and the country’s lack of fossil fuels. Nuclear energy now generates 78% of all French electricity, and the country is a net electricity exporter. In EDF and Areva, it has two of the world’s leading nuclear companies. France is now pioneering the construction of the latest-generation, missile-proof, earthquake-proof power plant, the EPR, with other countries set to adopt the same design.

Such French strategic planning is not only about long-term vision and infrastructure; it is also about putting in place the industrial supply chain needed to get there. The French state has either created

companies (EDF, Areva) or bailed-out troubled private ones (Alstom, the manufacturer of the TGV train) in order to keep the supply side going. Such planning extends to education too. France has a world-class layer of engineering, business and public-administration schools, known as *grandes écoles*, which churn out a technically skilled elite to run such firms. It is no coincidence that the bosses of EDF (Pierre Gadonneix), Alstom (Patrick Kron), and Areva (Anne Lauvergeon, see Face Value) are all graduates of *grandes écoles* in science or engineering.

The impulse to control, which underpins the French model, extends to the third function of the state too, that of regulator. The French are champion rule-makers. There are rules about how many pharmacies any one pharmacist can own (one), and how many taxis there are on the Paris streets (15,300). There are rules about when lorries can use motorways (not on Sundays), or when shops can hold sales (twice a year, on dates set by officials). New rules allowing shops to pick freely another two weeks have been greeted as a revolution. “To have cut-price discounts in April without waiting for the June sales is unheard-of!” exclaimed *Le Parisien* newspaper. Some of these rules seem absurd. But, in the financial sector, France’s regulatory urge has served it well in the current crisis.

France’s big banks may have lost plenty of money, but they have certainly performed better than their British or American peers, and most are still in profit. One reason is tighter regulation. Take the mortgage market. French banks have generally been far more wary about lending to homebuyers. In 2007 French mortgage debt represented only 35% of GDP, according to the European Mortgage Federation, less than in Germany (48%) and way off that in the housing-bubble economies of Britain (86%), Ireland (75%) and Spain (62%). French house prices did rise strongly. But the Bank of France argues that this was as much because of demographic growth, higher real disposable income and limited housing supply as speculative buying.

How far all this is due to regulation is hard to measure precisely. One leading French official reckons the answer is half thanks to a tradition of cautious borrowing, and half thanks to stricter rules. France applies tighter rules on bank capitalisation than international standards dictate. The regulator also recommends that banks should not make loans on which interest payments represent more than a third of the borrower’s income. Banks are under a legal obligation not to push borrowers into more debt than they can manage, and cases are regularly brought to court. So caution is built into the system.

Now for the flipside

If the French model has broadly sheltered its people from credit-fuelled excess, kept demand buoyant and inequalities manageable, and delivered well scrubbed buildings and blooming flowerbeds to boot, does this mean that the model works? Or what is the catch? The answer lies in a generally disappointing macroeconomic performance, with low growth and high unemployment, and is explained by the flipside of each of the three roles the French model allocates to the state.

First, as a provider, the government taxes employers and employees with such heavy social-security contributions to pay for all the health and welfare that it ends up deterring firms from creating jobs in the first place. One reason why French workers are more productive per hour than Americans is that firms employ so few of them. Many make widespread use of rotating interns and temps. One fast-food boss says that he staffs the same restaurants in France with two-thirds of the numbers hired in Britain. France’s jobless rate (8.6%) may now be the same as America’s (8.5%). But, unlike America’s, it never falls much below 8% even in good times.

The upshot is a split employment market. On one side, decent permanent jobs, protected by industry-wide conventions negotiated by the unions. On the other, unprotected short-term work—or none at all. The young are particularly shut out: joblessness for the under-25s is 21%. On some housing projects in the heavily Muslim *banlieues*, the rate is double that.

Illustration by Matt Herring

The state as planner has its flaws too. French industrial policy has evolved, and is no longer just about big planes, trains and cars. There is, for instance, a generous new research tax credit for companies, designed to boost innovation in industry particularly in the carbon-light and high-tech sectors. A new “auto-entrepreneur” system to encourage self-employment, and run on the basis of “no profit earned, no tax due”, has lured a massive 145,000 people since it was launched in January, well ahead of official expectations. “Anybody who says that the French just want to be civil servants and not entrepreneurs hasn’t got it,” declares Ms

Lagarde.

But, as a senior French official points out, the Colbertist engineering culture is on the whole much better at devising and managing big planned projects than it is at dealing with bottom-up ideas and uncertain markets. France lacks start-ups, and its small firms have difficulty growing. Hardly any of the biggest companies listed on the Paris bourse were founded in the past 50 years. Moreover, the old-style policy of picking national champions has had, at best, a mixed record. Transport and utility firms may be one thing. In other sectors, including computers (remember Groupe Bull) or banking (think of Crédit Lyonnais under state ownership), it has been a disaster. Even the French have been unwinding public stakes in private enterprise over the past 15 years. There has been no widespread nationalisation for more than a quarter of a century.

Nor is the egalitarian impulse necessarily a guarantor of quality, as French universities demonstrate. In reality, France has two-tier higher education: its world-class *grandes écoles* cater to a tiny elite, and its broadly second-rate universities fail the masses. Tuition at universities is free. There is no undergraduate selection at entry. Recent reforms have begun to inject an element of competition, and could produce centres of excellence in time. But, for the rest, a virulent distrust of competition and selection has led to overcrowded amphitheatres, an oversupply of philosophy and sociology students and high drop-out rates. In the Shanghai Jiao Tong University's world ranking, not one French university makes it into the top 40.

As for the state as regulator, it may have protected the French economy from extreme volatility, but that goes for the upside too. A more stable economy in a recession also means a less dynamic, less innovative economy in good times. For all its positive elements, the French model has not yet not incorporated enough flexibility, leaving it with the task of ensuring solidarity, but not the dynamic growth needed to sustain it in the long run.

The Supreme Court

Following Souter

May 7th 2009 | WASHINGTON, DC
From The Economist print edition

Barack Obama has a chance to rejuvenate the Supreme Court's liberal wing

AP

DAVID SOUTER (second from right, above) is a singular character. Though wealthy, he lives the life of Diogenes. He lunches frugally at his desk, typically on yogurt and an apple, which he eats to the core. He seldom goes out. He has no time for modern distractions such as television. But most unusually of all, despite having life tenure as a judge on the Supreme Court, he is planning to retire at the tender age of 69.

He loves judging but hates Washington, DC. He calls it the worst city in the world, though he has barely travelled. He yearns to return to his home in a tiny hamlet in New Hampshire, a dilapidated wooden farmhouse where he lives alone. His announcement, on May 1st, sent ripples of excitement through the city he despises. President Barack Obama now has a chance to pep up the court's liberal wing with a youthful replacement.

The Supreme Court matters. Its nine members decide what the constitution means. When there is doubt as to whether a law, a president or the actions of a local police department are lawful, the nine get the final say. Their decisions cannot be overruled, except by a future Supreme Court or a constitutional amendment. And they are appointed for life.

Small wonder that confirmation hearings for nominees are ferocious. One jurist with superb qualifications was scuppered when it was revealed that, at the age of 12, he had described the film "To Kill a Mockingbird" as "kind of boring". Obviously a racist, concluded the Senate. Another candidate had once offered to marry his girlfriend if she was pregnant. This proved he was "maniacally" opposed to abortion, said the chairman of the Senate Judiciary Committee, a windbag who "had uttered his first full sentence at the age of 14 months and hadn't stopped since."

These, as it happens, are scenes from "Supreme Courtship", an amusing novel by Christopher Buckley. But reality is not so far removed from satire. When Robert Bork, a learned conservative judge, was nominated to the Supreme Court in 1987, Ted Kennedy called him a "Neanderthal" who would bring back segregated lunch counters and slam the courthouse doors "on the fingers of millions of citizens for whom the judiciary is often the only protector of…individual rights." Mr Bork was not confirmed. Clarence Thomas, a black conservative, was narrowly confirmed in 1991, but only after enduring what he called a "high-tech lynching" over allegations that he sexually harassed a colleague.

Mr Souter, who was picked by President George Bush senior in 1990, escaped with only a light hazing, largely because he was so little known. At the time of his nomination he had been an appeals court judge for only two months. Mr Bush figured that Senate Democrats would be unable to attack his record because there was no record to attack.

This brilliant plan backfired. Mr Bush had been assured that Mr Souter was a staunch conservative; he proved to be anything but. Pro-lifers who expected him to help overturn *Roe v Wade*, the 1973 Supreme Court decision that established a right to abortion, were disappointed. He had a chance to scrap it in 1992. Instead, he reaffirmed it. The same year, he joined a 5-4 majority upholding the ban on prayer in public schools. And in 2000, in *Bush v Gore*, he voted against automatically awarding the presidency to the son of the man who nominated him. As some readers will recall, he lost that one. He is said to have considered resigning.

In 2005 Mr Souter sparked another controversy by voting to allow the government to seize people's homes and hand the land to private developers. The constitution allows the expropriation of private property for "public use", such as building a road. In *Kelo v New London*, a town in Connecticut wanted to evict some homeowners and replace them with wealthier people and businesses who might pay higher taxes. Mr Souter and four other justices thought that was just fine. Outraged property-rights sticklers proposed to have Mr Souter's home bulldozed and replaced with a hotel. They failed, of course, but most states have since passed laws curbing the power of local governments to grab land on behalf of private corporations.

In the past year, in cases that were not decided unanimously, Mr Souter has voted 86% of the time with Ruth Bader Ginsburg, the Supreme Court's liberal lioness. He agreed with Samuel Alito, a young conservative, only 14% of the time. Republicans rate him one of the elder President Bush's biggest mistakes. Democrats, having been pleasantly surprised, hope that Mr Obama does not hand them the other sort of surprise with his replacement.

That seems unlikely. With at least 59 Democrats in the 100-seat Senate, Mr Obama can be fairly sure that his choice will be confirmed. The question is: what sort of judge would he like? The answer is unclear. Although Mr Obama has taught constitutional law and edited the *Harvard Law Review*, his opinions on constitutional matters are hard to pin down.

When campaigning for the Democratic nomination, he told liberals what they wanted to hear. Addressing a Planned Parenthood conference in 2007, he said: "[W]e need somebody who's got the heart, the empathy, to recognise what it's like to be a young teenage mom [or] poor or African-American or gay or disabled or old. And that's the [criterion] by which I'll be selecting my judges."

For conservatives, this was alarming. Justice is supposed to be blind, not empathetic. As conservatives see it, liberal judges have repeatedly subverted the rule of law in recent decades by overruling elected lawmakers with scant constitutional justification. *Roe v Wade,* which relies on a constitutional right to privacy that is nowhere written in the constitution, is the most controversial example.

But as president Mr Obama has sent out mixed signals. On the one hand, he says he wants "someone who understands that justice isn't about some abstract legal theory or footnote in a casebook. It is also about how our laws affect the daily realities of people's lives." That sounds like a prescription for judicial activism. But Mr Obama also says he wants "somebody who is dedicated to the rule of law, who honours our constitutional traditions… and the appropriate limits of the judicial role". That is exactly what conservatives say they want.

So no one knows what to expect. Many Democrats want him to choose a Hispanic woman, since the court currently has no Hispanics and only one woman. Speculation swirls around Sonia Sotomayor, an appeals court judge who grew up in poverty in the South Bronx after her father, a manual labourer from Puerto Rico, died when she was nine.

It could be no more than speculation, however. Unkind critics question Ms Sotomayor's intellect. And she upset many with her ruling in *Ricci v DeStefano*, a case now before the Supreme Court. A group of white firefighters sued for racial discrimination when they were denied promotions. They had passed an aptitude test, but because none of their black colleagues passed, the city decided to promote no one. Ms Sotomayor sided with the city.

The conventional wisdom about Mr Souter's retirement is that an ageing liberal will simply be replaced by a younger one. On the most angrily debated issues, such as abortion, that may be true. And the court

may soon be forced to rule on some aspect of gay marriage, although the states seem for now to be liberalising apace without direction from above. But Mr Souter does not entirely fit the liberal stereotype. For example, he complains about the “stark unpredictability” of the punitive damages that lawyers often urge juries to impose. Last year he wrote the majority opinion striking down a $2.5 billion award against Exxon for an oil spill in Alaska.

The next court could hear plenty of commercial cases, not least because the recession has spurred the federal government to involve itself more in private business. Mr Obama is propping up banks, managing car firms, re-writing mortgage contracts and chasing white-collar criminals. All these ventures raise legal questions. Mr Obama will want an ally on the Supreme Court; but as Mr Souter’s career attests, unsackable judges make unpredictable allies.

Cuba and America

Gently does it

May 7th 2009 | MIAMI
From The Economist print edition

Cuban-Americans mostly feel that Barack Obama is making the right conciliatory gestures

Reuters

A long-delayed embrace

WHEN the Obama administration relaxed restrictions on travel to Cuba, Yanaisy Queija wasted no time. Taking a week's holiday from her job at a computer-parts factory, she checked in on May 2nd for the 45-minute flight from Miami to Havana, looking forward to seeing her father and grandparents. Because the previous administration limited Cuban-Americans to one visit every three years, she had not seen her relatives for two years.

The plane was crammed. Demand for seats on the handful of charter flights has risen by up to 60% since the restrictions were eased. New flights are being added, with bigger aircraft. Some older Cuban exiles insist that visiting Cuba simply puts money in the hands of the Castro regime, but Ms Queija had no qualms. She pointed to her luggage, bulging with toys, medicines and clothes. "None of this", she pointed out, "is for the government."

Barack Obama's policy shift fulfilled a promise he made to Cuban-American voters in May 2008 at a campaign stop in Miami. At the time, many thought he was taking a risk that might alienate hardline Cuban-Americans. But his move was designed to cause as little outrage as possible, while appealing to a new generation of exiles who are more progressive than those who fled the Castro regime in the 1960s.

At least 300,000 Cubans have come to the United States since 1994, when an accord was signed granting 20,000 American visas a year. The vast majority of newcomers are seeking the economic freedom Fidel Castro has denied them, not political asylum, and retain their strong ties to the island. "These people are not going to be aligned with virulent anti-communism," says Mario Loyola, a Cuban-American and former Republican foreign-policy adviser in the Senate. The new arrivals, he adds, are now reshaping Cuban Miami. "They don't understand a policy that isolates Cuba. They see Cuba as a prison. How does it make prisoners happy when you cut them off from the world?"

A recent opinion poll shows that 64% of Cuban-Americans approve of Mr Obama's travel policy, giving the president an overall approval rating of 67%. "For the first time, a majority of Cuban-Americans are aligned with a Democratic president on Cuba policy," says Fernand Amandi, who works with Bendixen & Associates, the Miami-based firm that conducted the poll. But hardliners reject the poll numbers, arguing that Bendixen polls are biased. Though they agree that Cubans should be allowed to visit their families, they are angry that Mr Obama gave Cuba a free pass. "This was a great opportunity to demand a good-faith gesture from Cuba, like releasing political prisoners," says Ninoska Pérez, a popular Cuban-American radio broadcaster.

Some of the older exiles, such as Carlos Trueba, a Cuban-born retiree playing dominoes in an outdoor park in Miami's Little Havana, object to the lack of ideological spine among the new arrivals. "Cubans come here asking for political asylum and then a year later turn right around and want to visit their family for a vacation. That's not right." Mario Diaz-Balart, a Republican congressman, goes further, likening those who favour Mr Obama's proposals to people who supported doing business with Hitler.

But most of Miami's right-wing Cuban-Americans leaders have fallen uncomfortably silent. This can be explained, in part, by the fact that Mr Obama has so far defended the 47-year-old trade embargo against Cuba. He is wise to do so, says Joe Garcia, a prominent Democratic Party activist and director of the Cuban-American National Foundation, an exile group that was once hardline but now backs greater engagement with Cuba. "The embargo is not a policy, it's a religion. So…you leave it alone."

If the president plays his cards right, he could pull off a political coup. "Obama is creating a whole new political base among Cuban-Americans," says Francisco Aruca, a moderate Cuban-American radio-show host who also runs one of the charter companies flying to Cuba. The relatively mild reaction of Cuban officials helps to strengthen the view that he is not caving in. In fact the Cuban government seems caught off-guard, tentatively welcoming the new Cuban-American visitors—and their money—while continuing to rail against the embargo and rejecting any call for concessions on its own part.

Other diplomatic action includes a meeting last week between the State Department's senior diplomat for Latin America, Thomas Shannon, and Cuba's top diplomat in Washington, Jorge Bolaños. The Obama administration has also chosen as its new ambassador to Mexico Carlos Pascual, a Cuban-American diplomat and leading author of a recent Brookings Institution study advocating engagement with Cuba.

Although Cuba was still on the State Department's annual list of state sponsors of terrorism, along with Iran, Syria and Sudan, when it was reissued last week, the report credited it with "no longer actively" supporting armed struggle around the globe. (Cuba remains on the list because it "continued to provide safe haven to several terrorists".) That is some progress.

American officials have privately made it clear that further steps towards better relations with Cuba can be expected. Most of these will be minor and incremental, such as reviving the talks on immigration that used to be held regularly but were suspended by the Bush administration. The next move could come from Congress when, this autumn, it takes up a bill to lift travel restrictions for all Americans. The bill already has 134 co-sponsors in the House; a bigger battle is expected in the Senate. Both houses passed a similar bill in 2003, but it was killed by Republican congressional leaders before it could make its way to Mr Bush's desk. If this time it gets passed, it is hard to see how the trade embargo could survive.

Tax dodges

Havens no more

May 7th 2009 | WASHINGTON, DC
From The Economist print edition

A crackdown on business taxes does not improve the tax code

Illustration by Claudio Munoz

FOR those who fear that Barack Obama is a business-basher at heart, this week brought plenty to fret about. On May 4th Mr Obama unveiled his plans to reform the rules on taxing the foreign earnings of American firms. They came with a fusillade of rhetoric about companies “shirking” their responsibilities, and the iniquities of a “broken” tax system that rewarded firms for creating jobs in Bangalore rather than Buffalo, New York.

As a “downpayment” on a “simpler and fairer and more efficient” tax system, which would also raise $210 billion over ten years, Mr Obama promised tighter rules on the taxation of businesses’ foreign earnings and a crackdown on the use of tax havens. He wants to make it harder for multinational firms to shift income to subsidiaries in low-tax countries, stiffen the rules on the credits American firms can claim for the foreign taxes they pay, and limit how much companies can defer tax payments on their foreign earnings. Under today’s rules American firms do not pay tax on profits earned abroad unless those profits are repatriated. Mr Obama wants to roll back this “deferral” by allowing firms to deduct the cost of investments abroad from their tax bill only once they have paid taxes on foreign profits. He has also vowed to get tough with individuals who park funds in tax havens to avoid American tax, and proposes an extra 800 inspectors to root out the scofflaws.

If the goal is to improve the tax code, this grab-bag of measures is deeply disappointing. No one doubts that America’s corporate-tax system is a Byzantine mess of high statutory rates and oodles of exemptions. But much of that complexity is caused by the divergence between America’s system of taxing its firms (and citizens) on their worldwide income and the territorial system used by most other countries. Mr Obama’s proposals, particularly his partial reversal of firms’ ability to defer taxes, would add yet more complexity. Nor is there much evidence that they would boost domestic job creation, as the administration claims. In fact, by raising the tax bills of American firms and putting them at a disadvantage beside their foreign peers, Mr Obama’s tax changes may reduce domestic job creation and even induce companies to move offshore.

In truth this plan is less an economic downpayment than a political one. Mr Obama needs more tax revenue, and corporate America’s foreign profits are an appealing pot of cash—particularly since Congress seems set to reject the administration’s other (sensible) plan to reduce tax deductions for richer folk. This week’s tough line may also be a useful bargaining chip with business. But the rhetoric is unconvincing. George Bush confused tax cuts with tax reform. Mr Obama seems to think reform lies in a tax crackdown; but he is wrong, too.

New York transport

A fare deal

May 7th 2009 | NEW YORK
From The Economist print edition

A state bail-out is the only way to keep the trains on the tracks

AMERICA'S fifth-biggest debtor, behind California, New York state and city, and Massachusetts, is a transport system: the Metropolitan Transportation Authority (MTA), which runs New York's subway, commuter trains and bus routes. And it is in terrible trouble. Passenger numbers are sliding, by 3.3% this February over last. Revenue from property taxes has been falling. The MTA now faces a deficit of $2 billion, and some 20% of its operating budget is now dedicated to repaying its debt.

A "Doomsday" budget, unveiled in November, envisaged cutting services and staff as well as increasing fares by up to 30%, by June 2009, to close the deficit gap. Two subway lines and dozens of bus routes were to be eliminated. The MTA called on the governor and Albany to produce a bail-out plan to offset the cost-cutting. The plan, the work of a commission headed by Richard Ravitch, who guided the MTA out of a crisis in the 1970s, was well-received by the lower house but failed to please the Senate. So there it has sat for five months, while the MTA has been on the verge of issuing pink slips to its employees.

The result has been growing commuter frustration. Flyers have been handed out in subway cars in the rush hour, urging travellers to boycott the MTA's planned fare increases. On April 28th a Facebook group called 1,000,000 People Against the NYC MTA Fare Hike held a rally in Manhattan's Union Square. But on May 5th David Paterson, New York's governor, Malcolm Smith, the Senate majority leader, and Sheldon Silver, the assembly speaker, the "three men in a room", at last came up with a $2.26 billion bail-out plan for the authority.

The plan calls for a base-fare increase of 25 cents and an $8 increase for the monthly MetroCard. Fares on commuter railways and tolls on MTA-operated bridges and tunnels will go up by 10%. Fares will jump another 7.5% in 2011 and again in 2013, but the increase will still be less than threatened. Fees for driving licences will rise by up to 30%; taxi rides will cost 50 cents more. The most controversial aspect of the bail-out is a payroll tax, which is expected to bring in $1.5 billion annually. Employers will pay 34 cents for every $100 in wages.

Not all the authority's problems can be solved at one fell swoop. Labour costs are crippling: pension and health-care costs have risen 42% in the past five years, according to the Manhattan Institute. After working for a mere 25 years, MTA employees can retire at 55 with a handsome pension. That perk is unlikely to be challenged, as union support is so strong. Still, the bail-out plan has pleased commuter advocates.

Capital spending is not ignored in it. Mr Sheldon insisted that it should be included, noting that "in the 1970s, we stopped investing in the MTA and it had a devastating impact". About $400m of the payroll tax will underwrite bonds, which will be used to borrow some $6.5 billion. Neysa Pranger of the Regional Plan Association, a body that plans for New York, New Jersey and Connecticut, is relieved about that, but wishes the two-year capital plan were longer. Big expansion projects already under way will take years to complete. It is worth remembering, she says, that "every dollar invested in maintaining the transit system returns $4 in economic benefits" for New York City and its region.

The Kentucky Derby

Celebration in recession

May 7th 2009 | LOUISVILLE, KENTUCKY
From The Economist print edition

Despite the downturn, quite a race was run

RACING fans often say that anything can happen. And at this year's Kentucky Derby, held in Louisville on May 2nd, anything did. In the final stretch an unheralded colt from New Mexico called Mine That Bird flew through the pack to win. The crowd rummaged in their programmes to remember the odds: 50 to 1.

Mine That Bird's upset victory was a happy finish for an event that had its share of troubles this year. As the big weekend approached hotel rooms were still available in downtown Louisville and, according to a local newspaper, women were reviving their old hats with new trimmings rather than splashing out on new ones. The swine-flu scare was unhelpful. Even the weather was unco-operative.

But the biggest shadow over the event was the remembrance of two sad stories from recent years. In 2006 the colt Barbaro won the Derby, and excited watchers wondered whether he could win the Triple Crown. Instead he shattered a leg at the Preakness Stakes in Maryland, and was eventually put down. In 2008 came the tragedy of Eight Belles. She came in second, but just after finishing both her front ankles snapped. She was euthanised on the track, in front of a stunned crowd. It was the first fatality in the Derby's history.

Those cases prompted reform. Thirty-five states now ban the use of most steroids in horse-racing, up from 12 a year ago. A new database tracks racing injuries. And caution tempers the odd bout of Derby fever. The favourite to win this year was a horse called I Want Revenge, but on race morning he turned up with a "hot spot" in one ankle and was scratched from the race.

In the end this year's festivities brought the city about $105m: down from $121m in a typical year, but better than organisers had expected. Attendance was down slightly, to about 154,000. But because tickets were more available, and air fares and other things were cheaper, some people were able to afford the Derby who would otherwise have been priced out.

The grandstand was filled with men in seersucker suits, braces and pocket squares. Women wore polka-dot dresses and enormous hats trimmed with flowers and feathers. Everyone drank mint juleps. Ryan Daly, a local film-maker, mused that if Chicago and New Orleans are big volumes in the American story, Louisville is "kind of the flimsy paperback on the middle of the shelf". The Derby, he reckons, reminds the city to celebrate itself.

Coal-fired power plants

The writing on the wall

May 7th 2009 | BOULDER, COLORADO
From The Economist print edition

Only green compromises will allow them to survive

THE coal-fired power plant that was cancelled in Michigan on May 1st is the 97th to be rejected since 2001, and the ninth this year. The number of planned coal plants across America has plummeted from 150 to 60 in the past five years. Last year 5,465 megawatts (MW) of new electricity were announced, but more than twice that capacity—12,572mw, according to Edison Electric Institute, which represents the electricity industry—was subtracted because of cancellations or delays. The nine coal plants cancelled this year alone, Edison notes ruefully, would have provided about 6,650mw of power, or enough to heat almost 5m homes.

Environmentalists, though thrilled, know they still have a long way to go. The Energy Information Administration reports that more than 600 coal-fired plants still produce about half of America's power and will still produce 47% of it in 2030. But the government has pledged to slash greenhouse-gas emissions by 80% by 2050. "If the [planned] coal plants don't get derailed, President Obama won't be able to cut greenhouse gas emissions in the next four years," says Bruce Nilles, who heads the Sierra Club's anti-coal campaign.

At least the Environmental Protection Administration (EPA), in a complete reversal from its role under the Bush administration, is doing its best for the cause. On April 27th it withdrew an air-quality permit it had issued for a 1,500mw pulverised coal-fired power plant, called Desert Rock, which was to be built on Navajo Nation land in New Mexico. In effect, this pulled the plug on the enterprise. That ruling was the first public consequence of an EPA mandate, issued on April 17th, that the most harmful heat-trapping greenhouse gases were a threat to public health and welfare and a cause of global warming. The mandate gives Barack Obama *carte blanche* to regulate the power industry.

Among the utility companies feeling the heat is NV Energy, which is postponing plans for a $5 billion, 1,500mw coal plant in eastern Nevada. Instead, it will harvest the state's plentiful solar and other renewable resources. Farther north, Southern Montana Electric Generation and Transmission Co-operative says "regulatory uncertainties" have forced it to defer plans for its 250mw Highwood coal plant near Great Falls. It proposes to build a smaller, cleaner-burning, natural-gas power station, as well as a previously announced 9mw wind farm. And several power companies are planning to convert older coal-burning plants to run on biomass, such as woody forest waste.

Renewable resources can't yet begin to replace coal as providers of power. But a deal struck in Kansas on May 4th, ending 19 months of impasse between Sunflower Electric Power corporation and the state government, shows under what conditions coal may be able to survive. Two coal-fired plants had been planned by Sunflower. It will now build just one, which will use new clean technology, offset carbon dioxide emissions and develop wind energy on the side. In return, the Kansas Department of Health and Environment cannot impose any greenhouse-gas regulations that are tougher than those emerging from Washington. Suddenly, that seems a pretty high bar.

Jack Kemp

Conservative hero

May 7th 2009 | WASHINGTON, DC
From The Economist print edition

A liberal Republican in the best sense

AP

Political savvy learnt from football

WINSTON CHURCHILL once said that he "preferred the past to the present and the present to the future". Jack Kemp had exactly the opposite point of view. For him the future always promised to be better than both the present and the past—provided that the government would just get out of the way.

Mr Kemp was one of the most prominent Republicans of his generation. He was secretary of housing and urban development under the first George Bush. He thought of running for the Republican nomination in 1996 and became Bob Dole's running-mate. But his real influence was ideological. He was a tireless advocate of supply-side economics: the man who persuaded Ronald Reagan to abandon deficit-hawk Republicanism in favour of aggressive tax cuts.

Mr Kemp started his career as a wiry, eager quarterback for the Buffalo Bills, before riding his popularity as a sports star to a seat in Congress. There he was consumed by a vision of how to make the world better. He lent his name to the Kemp-Roth tax cuts of 1981, one of the opening salvos of the Reagan revolution, and championed school vouchers, enterprise zones and housing vouchers.

The traditional wing of the party thought him a blow-dried wonder, but he could give as good as he got. In 1985 Bob Dole mocked him for wanting "a business deduction for hairspray". Mr Kemp shot back: "In a recent fire, Bob Dole's library burned down. Both books were lost. And he hadn't even finished colouring one of them."

Mr Kemp's world view was shaped by three things. Sympathy for the blacks he had got to know as a football player; contempt for urban liberalism, which he had seen at work in Buffalo, with its blighted housing estates and failed schools; and his commitment to supply-side economics. He never lost his enthusiasm for cutting taxes and expanding opportunities: virtues he had learnt as a not-so-dumb jock.

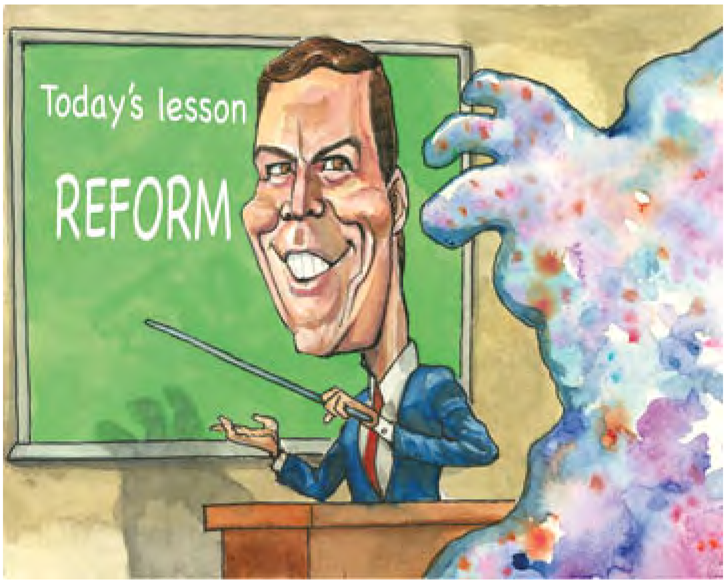
Lexington

The golden boy and the blob

May 7th 2009
From The Economist print edition

Is Barack Obama's education secretary too good to be true?

Illustration by KAL



IT IS hard to find anybody with a bad word to say about Arne Duncan, Barack Obama's young education secretary. Margaret Spellings, his predecessor in the Bush administration, calls him "a visionary leader and fellow reformer". During his confirmation hearings Lamar Alexander, a senator from Tennessee and himself a former education secretary, sounded more like a lovesick schoolgirl than a member of the opposition party: "I think you're the best." Enthusiastic without being over-the-top, pragmatic without being a pushover, he is also the perfect embodiment of *mens sana in corpore sano*—tall and lean, clean-cut and athletic, a Thomas Arnold for the digital age.

Since moving to the Education Department a couple of months ago he has been a tireless preacher of the reform gospel. He supports charter schools and merit pay, accountability and transparency, but also litters his speeches with more unfamiliar ideas. He argues that one of the biggest problems in education is how to attract and use talent. All too often the education system allocates the best teachers to the cushiest schools rather than the toughest. Mr Duncan also stresses the importance of "replicating" success. His department, he says, should promote winning ideas (such as "Teach for America", a programme that sends high-flying university graduates to teach in underserved schools) rather than merely enforcing the status quo.

Nor is this just talk. Mr Duncan did much to consolidate his reputation as a reformer on May 6th, when the White House announced that it will try to extend Washington, DC's voucher programme until all 1,716 children taking part have graduated from high school. The Democrat-controlled Congress has been trying to smother the programme by removing funding. But Mr Duncan has vigorously argued that it does not make sense "to take kids out of a school where they're happy and safe and satisfied and learning". He and Mr Obama will now try to persuade Congress not to kill the programme.

Mr Duncan is arguably the luckiest education secretary since Jimmy Carter created his department in 1979. He inherits a much richer legacy from the Bush administration than most people imagine, with mounting evidence that George Bush's No Child Left Behind Act did something to boost educational achievement, particularly among poor children. And a growing number of Democrats, many of them black, think the party needs to distance itself from the teachers' unions. Cory Booker, the mayor of Newark, argues that "as Democrats we have been wrong on education, and it's time to get it right."

At the same time, Mr Duncan is being showered with money by his boss. The stimulus bill will provide him with an extra $100 billion to improve America's schools, the biggest educational windfall in the country's history. He also has a $5 billion budget for the specific purpose of encouraging educational innovation.

Mr Duncan is the perfect man to capitalise on these opportunities. His mother founded and ran an after-school programme for poor children on Chicago's South Side. He spent seven years as the CEO of the Chicago public schools, the third-largest system in the country, closing bad schools and shifting resources to more successful ones. He also has the most valuable resource of any ambitious reformer—a close bond with the president. They have a Harvard education in common, along with roots in Chicago's Hyde Park district, and frequently play basketball together.

Mr Obama, too, is passionate about education, convinced that it holds the key to two of his most cherished domestic reforms: narrowing the income gap between rich and poor and boosting the productivity of the average worker. The president and his wife are living examples of how education can achieve the American dream. Mr Duncan seldom fails to remind his audience that, thanks to the first family, "Never before has being smart been so cool." On May 6th the president also demonstrated that he is willing to annoy the teachers' unions, who regard Washington's school-voucher programme as the spawn of the devil.

Enemies of promise

Yet it is hard to suppress a feeling that all this is too good to be true. To begin with, Messrs Duncan and Obama have given the voucher scheme only a stay of execution. No new children will be admitted to the scheme, despite its popularity with poor Washingtonians. The stay of execution had a lot to do with political expediency. Ending the scheme immediately would not only have disrupted the education of 1,700 children; it would also have exposed both Mr Duncan and his boss to charges of hypocrisy. Mr Duncan sends his children to school in Virginia, and Mr Obama pays for his two daughters to go to Sidwell Friends.

But the bigger reason to be pessimistic about Mr Duncan is that the education establishment has an astonishing record of neutralising reform-minded politicians. Entrenched vested interests and a decentralised system—with much of the day-to-day decision-making controlled by 16,000 school districts—combine to squash most promises of improvement. The mighty teachers' unions regularly welcome reforms in theory while destroying them in practice. Bill Bennett, Ronald Reagan's education secretary, perfectly described this slippery bunch as "the blob".

The battle between Mr Duncan and the blob is a crucial one. The result of the battle will determine, first, whether it is worth continuing with moderate education reforms—for if these reforms cannot succeed with $100 billion and a golden boy at the helm, they never will. It will also determine whether Mr Obama can deliver on his promise to build the American economy on the rock of well-educated and productive workers rather than the sand of financial speculation. A pity that, however many battles it loses, the blob always seems to win the long war.

Economist.com / blogs / lexington

Award: Democracy in America

May 7th 2009
From The Economist print edition

Democracy in America, our blog on American politics edited by Roger McShane, has won the 2009 Webby Award for best political blog. The Webbys, presented by the International Academy of Digital Arts and Sciences, honour excellence on the internet.

Mexico

The cracks opened up by the flu

May 7th 2009 | MEXICO CITY
From The Economist print edition

As the swine-flu outbreak appears to subside, Mexico is left to contemplate the cost and to ponder the authorities' response

Reuters

AFTER almost a fortnight of high alert and a five-day shutdown of ghostly calm, Mexico City this week began gingerly to return to its normal metropolitan bustle. Fears that swine flu might be a deadly epidemic have subsided: testing has shown that it was responsible for fewer than 50 of the 159 deaths that it was reported to have caused in Mexico. So far it seems to be barely more contagious than normal influenza, and is treatable with antiviral drugs. On May 6th Mexico City's municipal government lifted a weeklong ban on restaurants seating customers. The national government allowed universities, high schools, churches and museums to reopen from the following day, while primary schools will do so on May 11th. Mexicans are dispensing with their face masks, and breathing a sigh of relief.

As they do so an inquest is starting into the authorities' handling of what has turned out thus far to be a fairly mild bug. To some, the official reaction was both tardy and excessive. The first patient known to have had swine flu, Édgar Hernández, a small boy in a village in the eastern state of Veracruz, saw a doctor on April 2nd. The first confirmed death—Adela María Gutiérrez, a 39-year-old woman in the southern state of Oaxaca—occurred on April 13th. But the authorities did not send samples abroad for genomic analysis, the process that eventually identified the new virus, until April 22nd. They did not acquire the technology to test for themselves for another week. "They should have analysed the samples immediately," says Laura Moreno Altamirano, a professor of public health at the National Autonomous University of Mexico. "Then they would have known that the virus wasn't so aggressive, and they wouldn't have had to implement all these measures."

Those measures included closing schools, football stadiums, gyms, cinemas, bars and nightclubs; cancelling concerts, plays, festivals and church services; limiting restaurant services to takeaway and delivery; and augmenting a public holiday by a day to create the five-day shutdown.

This shutdown hit the economy hard. Because of its close links with America's economy, and especially its crippled car industry, Mexico had already slid into a deep and worsening recession. In February output shrank by 10.8% compared with the same month last year, the worst number since these figures began to be collected in 1993. Agustín Carstens, the finance minister, said that the swine-flu outbreak will lop an extra 0.3% from GDP this year. Some private estimates are much higher.

The government has announced $1.3 billion in tax breaks and spending to help offset these losses, which will be financed with borrowing. But the damage to Mexico's image abroad, and therefore to its tourism industry and food exports, may be long-lasting. Hotel occupancy has fallen to single digits. Several airlines have stopped flying to the country. Eight countries, including China and Russia, have banned some Mexican farm products. (China this week allowed a plane chartered by the Mexican government to pick up 71 Mexican citizens whom it had quarantined, although they had no flu symptoms.)

The episode has also exposed inequalities in Mexico's health services. Many patients, particularly those in poor rural areas, receive dubious care or no care at all. Poorer people often prefer to buy drugs at a pharmacy instead of losing a day's work dealing with the public-health bureaucracy, says Verónica Baz of CIDAC, a think-tank in Mexico City.

Local media reported several cases of ambulance drivers refusing to transport patients, and of hospitals lacking antiviral drugs. Rogelio Pérez Padilla, the director of the National Institute for Respiratory Diseases, admits there were "time lapses in distribution" from the government's strategic reserve of 1.8m doses. But in a big developing country of 110m people, "some delays were to be expected," he said.

The critics, of course, enjoy perfect hindsight. Miguel Ángel Lezana, the government's chief epidemiologist, notes that between 1,500 and 1,800 Mexicans typically die of flu each year during March and April. There was no reason to suspect a new virus, he says, until a spike in cases among the young and healthy appeared towards the end of the flu season in early April. The subsequent fall in the number of cases is because of the government's decisive action to impede the spread of the infection, according to José Ángel Córdova, the health minister.

Public opinion seems to agree. Polls show that around 70% of respondents approve of President Felipe Calderón's handling of the swine-flu outbreak and of his overall performance. His government will soon be held to account, in a mid-term Congressional election on July 5th. The sickly economy, and doubts about whether Mr Calderón is winning a battle to tame violent drug-trafficking gangs, have given the opposition plenty of ammunition.

But the polls show his conservative National Action Party starting to cut what was a double-digit lead for the formerly ruling, centrist Institutional Revolutionary Party to around five points. It is a Mexican instinct to rally round the leader at a time of trial. As normality returns, Mr Calderón will have to persuade his people that his government's actions saved lives.

St Pierre and Miquelon

Squaring off for a seabed scrap

May 7th 2009 | OTTAWA
From The Economist print edition

A French speck takes on Canada

DESPITE the promise of its original name—the Islands of the 11,000 Virgins—bestowed by a 16th-century Portuguese explorer, the French archipelago of St Pierre and Miquelon off Canada's east coast is hardly a paradise. It boasts of baking North America's best croissants. Apart from that, its assets are rocks, fog and a strategic location. A brief period of liquor-fuelled prosperity during the Prohibition era in the United States was followed by a long economic decline mirroring that of cod stocks in the surrounding North Atlantic.

The 6,000 residents of this last remnant of the French empire in North America hope the future lies with offshore oil and gas, which has enriched its neighbour, Newfoundland. Pressed by the islanders, the French government plans to file a claim to an area of the extended continental shelf south of the archipelago to a United Nations body which has been set up to administer claims to the seabed around the world. Countries such as France which ratified the UN Convention on the Law of the Sea before May 1999 have until May 13th this year to file their claims. Negotiations will then follow.

Nevertheless, Canada seems to feel threatened by the impending French claim. It said, wrongly, that the matter had been settled by arbitration in 1992 and that it would "take all necessary measures to defend and protect its rights." (Canada has until 2013 to file its claim.) In fact the 1992 decision fixed the maritime boundaries between Canada and the islands, and did not demarcate the continental shelf.

This tussle echoes the conflicting claims filed by Britain and Argentina to the seabed surrounding the Falkland Islands. The *miquelonais* accuse Canada of spying on France during the 1992 proceedings. They think it unfair that the Canadian government should use as the base point for its claim Sable Island, an islet in the Atlantic inhabited by feral horses, seals and a handful of government scientists.

The islanders also worry that France may not fight hard for them. Some still recall rumours in the 1930s that they would be sold to America. Whereas the French government has filed claims complete with detailed maps and scientific data to the UN commission on behalf of the French Antilles, French Guiana, New Caledonia and the Kerguelen Islands off Antarctica, all that is promised for St Pierre and Miquelon is a letter of intent. Perhaps it's time to join Canada.

Trade unions in Venezuela

Socialism v labour

May 7th 2009 | CARACAS
From The Economist print edition

Curbing opposition to chavismo

HIS government espouses "21st-century socialism" and claims to stand for the working class. Yet Hugo Chávez, Venezuela's president, has never been a fan of his country's trade unions. He portrays them as corrupt vestiges of a capitalist past and of the previous political order. Ever since he was first elected, in 1998, he has sought ways to bring them to heel. Having first tried and failed to take over the main trade-union confederation, he encouraged a pro-government rival. Now he wants to bypass the unions altogether, by establishing in their place "workers' councils" that amount to branches of the ruling Unified Socialist Party of Venezuela (PSUV).

A bill in the government-controlled National Assembly would eliminate collective bargaining and give powers in labour matters to the new councils. "The government's policy is the total elimination of the union movement," says Orlando Chirino, a former *chavista* who is one of the architects of the Labour Solidarity Movement, a new group which embraces unions from both sides of the country's political divide and which defends union autonomy.

The bill comes hand-in-hand with the slowdown in the economy and a government crackdown on opposition politicians. Its onslaught on the unions, and its refusal to negotiate collective contracts—or to respect them once signed—is meeting resistance. Labour disputes are increasing, from 46 in January, to 59 in February and 113 in March, according to figures compiled by Victorino Márquez, a labour specialist at the Catholic University in Caracas.

With budgets slashed following the fall in the oil price, the government can no longer buy industrial peace. It is starting to resort to force. A strike in the Caracas metro was averted by the threat of military intervention. Mr Chávez called the metro workers "corrupt" for insisting on the implementation of an agreement that had already been signed. According to press reports, dozens of trade unionists are being prosecuted. Their alleged crimes include "subversion" and holding demonstrations in "security zones" such as those around big factories. Scores have been murdered, in disputes over contracts that mainly involve pro-government unions.

Only about 11% of the workforce belongs to a union. The bedrock of Mr Chávez's support has long lain with non-unionised workers in the vast informal economy. But unionised workers are concentrated in important parts of the economy, including the oil industry and the heavy-industrial centre of Ciudad Guayana in the south-east. Both are in ferment over wage demands. Disputes are also brewing among teachers, health workers and in the electricity industry.

The oil industry could be the biggest flashpoint. The government is refusing to negotiate wages and conditions until the oil workers' federation elects a new leadership in a ballot due later this month. There are signs that the government wants to delay the vote. The budget of Petróleos de Venezuela (PDVSA), the state-owned oil company, has been slashed by more than half this year. Rafael Ramírez, the energy minister and head of PDVSA, said there would be no pay rise, even though inflation is close to 30%. He later backtracked.

Mr Chávez insists that only the rich will pay the price of the impending recession. But workers are already feeling its effects. The government seems to welcome the looming confrontation with the unions, as an opportunity to crush dissent and take Mr Chávez's "revolution" to the next level. Jorge Giordani, the planning minister, said recently that the inflation rate should not be the main factor in setting the minimum wage. He added that he knew of no example in the world where socialism had been established on the basis of abundance. "Socialism has emerged from scarcity," he declared.

On May Day the politically divided unions staged two separate marches, as they have for the past few years. The non-government march was broken up by police and national-guard troops using tear gas and

water-cannon. “There is no socialism without the working class,” Mr Chávez told a rival march of his supporters. By fomenting division and repressing dissent, Mr Chávez may succeed in crushing the labour movement. With it would go one of the few remaining institutions of democracy and pluralism in Venezuela. And Mr Giordani may get the chance to implement the socialism of scarcity in what was once the richest country in Latin America.

Panama's presidential election

Super 09

May 7th 2009 | PANAMA CITY
From The Economist print edition

A supermarket king defeats the left

Reuters

Martinelli piled the votes high

AFTER a string of Latin American election victories for the left, Panama has bucked the trend. Ricardo Martinelli, a wealthy businessman running as a centrist independent, trounced the candidate of the governing centre-left Democratic Revolutionary Party (PRD), winning 60% of the vote in a presidential election on May 3rd. But his victory owed as much to local peculiarities as to new regional trends.

Panama is suffering a sudden economic slowdown after a wild boom. With foreign investment pouring in to property development and new ports, the economy has grown at around 8% a year for five years. Now Panamanians are suffering from a property bust and rising food prices. Even so, Martín Torrijos, the outgoing president, remains popular. But his party's candidate, Balbina Herrera, was unable to live down her reputation as a henchwoman of General Manuel Noriega, the thuggish strongman who controlled Panama before being ousted by an American invasion in 1989.

The main beneficiary of her unpopularity, however, was not the centre-right opposition Partido Panameñista, which has alternated in power with the PRD since the invasion. Mr Martinelli, who owns Super 99, the country's largest supermarket chain, managed to profit from disillusion at political corruption by posing as an outsider. He poured part of his fortune into a clever campaign. "What we're trying to prove is that you can solve the social problem with a government of the centre through democracy and free enterprise," said Roberto Henríquez, a leader of his party.

Mr Martinelli wants to offer tax breaks to foreign investors, but he also promised a non-contributory pension for the poor. He pledged to crack down on rising crime. He contrived an image as an ordinary guy who worked hard to rebuild his business after his supermarkets were looted during the invasion. Ms Herrera had the support of Rubén Blades, an ageing salsa icon who is Mr Torrijos's tourism minister; Mr Martinelli hung out with DJ Black, a reggae artist popular with young Panamanians.

Mr Martinelli's business interests also extend to stakes in a bank, electricity generation and sugar. Ms Herrera claimed that his wealth is $400m (or almost 2% of Panama's GDP). He has obvious conflicts of interest: he proposes to cut corporate tax, for example. But most of the voters didn't seem to care much about that. They want him to run the country as well as he manages his businesses.

Crime in Peru

Printing money

May 7th 2009 | LIMA
From The Economist print edition

Quantitative easing in a new capital of counterfeiting

NOT to be outdone by the world’s central bankers, some Peruvians have taken to printing money. In the past two months, Peru’s police have seized some $40m in near-perfect replicas of American dollar bills in $20, $50 and $100 denominations, as well as $5m in fake Peruvian currency and smaller amounts of Venezuelan bolívares and of euros. That compares with total worldwide seizures of counterfeit dollars by the United States Secret Service (one of whose jobs is to protect the integrity of the currency) of $103m between October 2007 and August 2008. These figures suggest that Lima has become the counterfeiting capital of the Americas.

Colonel Alejandro Díaz, who heads the fraud unit of Peru’s National Police, suspects that the counterfeiters have moved to Lima from Colombia, which was an important source of fake dollars. The police surmise a link between counterfeiting and drug trafficking. Apart from the fake money, Peruvian counterfeiters have also become adept at forging passports, visas and the requisite seals and stamps needed for travel around the world. In one raid, officers seized passports from 16 different countries, from China to Poland.

The immigration service has detected several ways in which travellers are entering Peru without proper documents. They use the country as a staging area to get to North America or Europe. Many of these cases involve Chinese who make their way to Peru, obtain fake Japanese documents and then try to travel to the United States.

Colonel Díaz says that most of the fake dollars are sent to Ecuador and El Salvador, which together with Panama use the greenback as their national currency. Just as the Federal Reserve has adopted “quantitative easing” to inject more liquidity into the American economy, it seems that the informal economy may have found a way to expand the money supply in these countries.

Nepal's political crisis

How fierce will the Maoists be now?

May 7th 2009 | KATHMANDU
From The Economist print edition

Frustrated by an unbiddable general, the Maoists quit the government, and Nepal's hopes for peace recede

Reuters

IF NEPAL'S mainstream politicians, army and Big Brother, India did not like Maoists in government, it is hard to imagine how the scrubbed-up guerrillas will be improved out of it. The resignation of the Maoist prime minister, Pushpa Kamal Dahal, or Prachanda ("fierce"), on May 4th offers a chance to find out. Mr Dahal was protesting against a move by the president, egged on by the aforementioned critics, to reverse his sacking of the country's army chief, General Rookmangud Katawal. Unless President Ram Baran Yadav relents, the Maoists say they will not rejoin the government. The debacle has jeopardised an already flagging peace process.

General Katawal deserved the boot. A devotee of Nepal's deposed king, Gyanendra, whose office was abolished last year to draw the Maoists into Nepal's first post-war election, he has never hidden his hatred for his former foes in a decade-long conflict. In December, he refused to curtail a recruitment drive, which the UN called a violation of the 2006 peace agreement. When the government then refused his request to extend the service of eight brigadier-generals, he again resisted. After he forbade the army to take part in an athletics contest last month because the Maoists' former army, currently corralled under UN supervision, was also to take part, the government asked General Katawal to explain himself on all three issues. His haughty response prompted Mr Dahal's action.

The general's insubordination conceals a more serious disagreement: over how to dispose of the Maoists' former fighters. Under the terms of the peace agreement, negotiated between the Maoists and their political opponents under India's aegis, some of the 23,000-odd corralled must be recruited into the army. The instrument of a power grab by Gyanendra in 2005, the army must meanwhile be made less elitist and more accountable. But General Katawal, with India's blessing, has resisted these reforms. Pointing to the Maoists' continuing revolutionary rhetoric, his backers argue that only an unreformed army can defend Nepal from its elected government. Kumar Madhav Nepal, a leader of a mainstream leftist party known as the UML, and touted as the next prime minister, says they "clearly want to capture power".

The Maoists' rhetoric is certainly worrying. So is the thuggery of their storm-trooping youth wing. Yet Maoist leaders also hint that their virulent rhetoric is to placate their frustrated rank-and-file. On May 6th, Mr Dahal said he would not join a national-unity government, as his opponents say they want, unless Mr Yadav reversed his decision; but the Maoists' democratic commitment was unchanged.

No doubt, he has given reason to doubt this. Yet worries about how easily the army might be corrupted by Maoist recruitment may be overblown. And the peace process, which should also entail accounting for the war's atrocities, is on hold. So is work on a drafting a new constitution, with which Nepal's elected assembly is primarily entrusted. With almost half its two-year term gone, little progress has been made, and, needing a two-thirds majority, is unlikely while the Maoists, who control 38% of the house, are in opposition.

Even with more goodwill, this exercise would be contested. The Maoists, in a draft constitution released in March, demand an executive presidency and extreme devolution of powers from the centre to 13 ethnically-based provinces. The UML wants a ceremonial president, a directly elected prime minister and a similar devolution, but to less ethnically-tinged states. The Nepali Congress, the third main party, advocates a Westminster-style parliamentary system, and less devolution.

While squabbling continues in Kathmandu, organic devolution is taking place in many mutinous places. It is most extreme in the southern Terai region, where a 2006 insurrection by ethnic Madhesis has sparked agitations by their neighbours. A militant group of Tharus, who claim to be the region's original inhabitants and 42% of its population (or double the government's estimate), rose up this year in protest against their official classification as Madhesis, and to demand Tharu control of an autonomous Terai.

This week, in response to Mr Dahal's resignation, the group ended its second two-week blockade of Kathmandu, which has worsened the capital's existing fuel shortage. Asked when this agitation might resume, the group's leader, a 34-year-old former Maoist fighter called Laxmi Tharu, replies cheerily: "As soon as the next government is formed."

India's election and the BJP

Saffron hopes

May 7th 2009 | MEERUT
From The Economist print edition

The BJP enjoys an optimistic moment

RICH, industrialised and with a history of Hindu-Muslim violence, Meerut, a city in western Uttar Pradesh (UP) which went to the polls on May 7th, should be easy pickings for the Bharatiya Janata Party (BJP). In the 1990s, when the Hindu nationalists were thrust to national power, they won three elections in Meerut in a row.

But there was little of the Hinduist party's saffron paraphernalia on display in the city of 1.3m. And on May 4th only 5,000 turned up to hear the BJP's most brilliant speaker, Narendra Modi, the demagogic chief minister of Gujarat. The previous day 100,000 Meerutis had shown up for a rally by the Samajwadi Party (SP), a low-caste party of UP, which featured Sanjay Dutt, a Bollywood star and criminal.

Indeed, the BJP is having a lacklustre election. It has mostly played down its Hindu-chauvinist ideology, Hindutva, which puts off many Indians, including the coalition allies it would need to form a government. This has caused discontent among the BJP's foot-soldiers, directed in particular at L.K. Advani, the party's 81-year-old prime-ministerial candidate.

The BJP's traditional boasts are to run the economy more skilfully and defend the nation more stoutly than does Congress, the other big party, which leads the outgoing coalition government. But with an estimated 1.5m jobs lost in exporting industries in the past six months, this is no time to talk of economic reform, of which Indians were wary even in fatter times. And Congress, stronger in poor, rural areas, is a more obvious champion of the jobless poor than is the BJP, with its base in richer urban places. Straining to counter this, the BJP's manifesto promises India's poorest families a monthly ration of 35kg (77lbs) of rice at only two rupees (four cents) a kilo; Congress promises three rupees a kilo.

Distracted by the economy, perhaps, Indians do not seem especially frightened for their security—which is surprising given last November's spectacular attack on Mumbai by Pakistani terrorists. That is bad for the BJP. Worse, Congress's leaders have outflanked it, by listing the many terrorist attacks that occurred during the last BJP-led government, from 1999 to 2004.

And yet the BJP suddenly seems more chipper. With 372 out of 543 seats decided, ahead of the election's fourth phase in western UP and elsewhere this week, it believed it had an edge over Congress. Without exit polls, which are restricted during the voting, the claim was unverifiable. But it is plausible, since several BJP strongholds, such as the states of Karnataka and Madhya Pradesh, have already voted. The BJP also claims it has done unexpectedly well in UP, while Congress has fared badly in its main earner, Andhra Pradesh (AP).

AP

Modi, leader in waiting?

That may not be true. But with Congress still favourite to win this vote, the BJP's burst of optimism was a useful reminder of how open the election really is. Congress's victory in India's last election, in 2004, was much less likely than a BJP victory would be in this one. And the margin of Congress's victory, by 145 seats to the BJP's 138, was hardly clinching. Moreover, the vote-spoiling effects of regional parties and independents could matter more than any aspect of Congress's or the BJP's campaign. In 2004 this helped ensure that Congress's seat-share climbed, while its vote-share fell. Together India's two biggest parties got only 49% of the vote; they are not expected to do better this time.

By tradition the party that comes out ahead has first dibs at forming a government. Either way, this could be messy. Congress has recently offloaded several erstwhile allies, including the SP; re-enlisting them will be costly. And it would probably leave Congress still short of the requisite 272 seats—not least because its

main remaining ally, Tamil Nadu's Dravida Munnetra Kazhagam, looks set for a pasting.

This might lead to a rerun of 2004, when Congress secured its majority by recruiting outside support from an alliance of Communist parties. Casting his net wide, Rahul Gandhi, the son of Congress's leader Sonia Gandhi, has suggested he would be open to this, and perhaps also to tie-ups with a former BJP ally in AP, the Telugu Desam Party (TDP), and a current one, the Janata Dal (United), or JD(U), in Bihar. The Communists, who abandoned the government last year in protest at its efforts to deepen India's ties with America, and who are currently fighting Congress in their main stronghold, West Bengal, predictably rubbished this prospect.

Yet for the BJP to build a coalition would be even harder. Several of its former allies, including the TDP, which abandoned it after the 2004 election, think they lost Muslim votes by the association. And Mr Advani, who is currently on trial in UP for inciting the destruction of a medieval mosque, Babri Masjid, by Hindu vandals in 1992, is a more divisive figure than was his predecessor, Atal Behari Vajpayee.

Mr Modi, whose government in 2002 presided over a slaughter of some 2,000 people in Gujarat, most of them Muslims, is most divisive of all. On April 27th the Supreme Court ordered an investigation into his role in a grisly episode in this pogrom. And on May 1st, frustrated by Gujarat's failure to bring the alleged ringleaders to justice, it ordered the creation of five special courts to try them.

The BJP's biggest draw, Mr Modi will harangue an estimated 270 rallies in this election—yet Nitish Kumar, the JD(U)'s leader, who has many Muslim followers, refuses to appear alongside him. Of course, it may be that given a promise of five years in a BJP-led government, and a lucrative ministry or two, such niceties will fade. If so, India may one day have a leader, Mr Modi, to whom America has denied a visa because of his alleged complicity in a massacre.

Fighting the Pakistani Taliban

The Swat test

May 7th 2009 | ISLAMABAD
From The Economist print edition

The peace deal forgotten, for now

MORE than 40,000 people this week fled the Swat valley in north-west Pakistan, as an onslaught against Taliban militants intensified. The provincial government issued a warning that a further 500,000, out of a population of 1.5m, might follow, though the Taliban have blocked roads with rocks and trees. Pakistan's army, which fought in Swat from 2007 until it struck peace in February, says it will now finish off the Taliban in the valley.

The peace deal has been unravelling since the Taliban last month moved from Swat into the districts of Lower Dir and Buner, 100km (63 miles) from Islamabad, the capital. The army attacked them, after senior American officials voiced their alarm at its "abdication" to the Taliban. Under the peace agreement, covering Malakand division, which includes Swat, the government is to implement Islamic law in the district. But Sufi Mohammed, an Islamist intermediary for the Taliban, did not like the government's version of *sharia*.

The Taliban call the government and army American stooges. On May 3rd militants beheaded two government officials in Swat, in revenge for the killing of two Taliban commanders in Dir and Buner. The next day they ambushed an army convoy in Swat. Gunfire rang out in the main city, Mingora, where armed Taliban reappeared on the streets. On May 6th Pakistani helicopter-gunships and ground troops attacked the Taliban in the valley.

Officials claim that by setting up *sharia* courts they have drawn local support away from the Taliban. Even if true, that support could be easily lost. In its previous campaigns in Swat, the army's use of mortars and aircraft killed scores of civilians.

The army claims to have killed over 30 militants in Swat and 100 in Buner. It plans to clear a route through Dir to Swat, where the fighting could be tougher. Militants have recruited young men, broadcast anti-government propaganda, dug trenches and laid mines throughout Mingora.

The army continues, for political reasons, to rely on the paramilitary Frontier Corps, drawn mainly from the local population, rather than regular soldiers. It is unclear whether it plans a sustained operation, or whether, after demonstrating its seriousness of purpose to its American ally, it will reinstate the peace deal.

The offensive in Swat came as Barack Obama and his Pakistani and Afghan counterparts, Asif Zardari and Hamid Karzai, met in Washington on May 6th. American officials had raised concerns about the security of Pakistan's nuclear arsenal, as well as its zeal for fighting the Taliban. Mr Obama called the talks "extraordinarily productive". But America's dialogue with Pakistan seems to have changed little since the former military ruler, Pervez Musharraf, reluctantly signed up to George Bush's "war on terror" in 2001. America demands a greater effort against the militants and pours in aid to encourage it. Pakistan responds that its past sacrifices are under-appreciated and future efforts will be redoubled; and takes the money.

Afghanistan's elections

Poll position

May 7th 2009 | KABUL
From The Economist print edition

Despite his unpopularity, Hamid Karzai is well placed for re-election

HAD the Pushtun tribes of southern Afghanistan undergone a silent revolution and embraced female equality? During registration earlier this year for Afghanistan's forthcoming presidential elections, the numbers of women voters reached improbable, then impossible proportions. In the final tally in Logar province, women made up 72% of voters. The trend was repeated in many areas of the ultraconservative south. The women were mostly registered by men collecting voting cards for supposed female relatives.

This is just one sign of the widespread fraud expected to be a feature of Afghanistan's elections, due in August. But it also suggests that Afghans feel the elections are worth trying to fix. That may be preferable to a boycott out of apathy or Taliban intimidation—the fear a few months ago.

Western diplomats worry in particular about the decision to count ballots in local polling stations and not at provincial level, as last time. Ostensibly this aids transparency. But local communities will in most cases vote as blocks, according to decisions made by local elders and power-brokers. Results posted by individual polling stations make them vulnerable to pressure.

This week the incumbent president, Hamid Karzai, registered himself as a candidate, and sent his foreign allies into a new fit of depression by naming a civil-war era warlord, Mohammad Fahim, as one of his running-mates. Mr Karzai shows every sign of defying the apparent unpopularity of his government both at home and abroad, and winning re-election.

If he does so it will reflect less his personal appeal (private polling at the start of the year suggested he is the most popular candidate but with only 15% support) and more the disunity and lack of broad-based appeal of his opponents. Several have dropped out in recent days, notably Gul Agha Sherzai, the energetic governor of Nangarhar province, who stood the best chance of taking southern Pushtun votes from Mr Karzai. Another candidate, Ali Jalali, complained that opposition figures were failing to challenge the incumbent because none would put aside his own ego to join a broad front. Mr Karzai also enjoys the benefits of incumbency, with the patronage he is able to offer.

The great unknown in the process remains the role of insecurity and the Taliban opposition. There were no big attacks on the process of voter registration. But the Taliban have a big influence in around 100 districts out of 400; 11 are entirely in Taliban hands. NATO forces must decide whether to try to clear these areas of the Taliban ahead of the polls, with the prospect of having to withdraw from most of them afterwards. The alternative is to encourage voters to go to neighbouring areas.

Reuters

The hat still fits Karzai

With much local power at stake in the concurrent provincial-council elections, it seems likely that there will be pressure on the insurgents to refrain from attacks on polling stations. Certainly the Taliban have generally avoided the sort of indiscriminate suicide spectaculars seen in Iraq.

There is even some evidence of a degree of internal dispute within the Taliban on how to proceed. In Uruzgan province, the commander of the Afghan Army, General Abdul Hamid, reports that many Taliban have registered to vote, and that there were clashes during registration between Taliban supporting and opposed to the election. The pro-election faction triumphed. NATO hopes that sets a trend.

Scandal in Indonesia

A fatal round

May 7th 2009 | JAKARTA
From The Economist print edition

Institutions on trial

AP


Antasari leaves the fairway

WHEN the police in Jakarta announced on May 4th that Antasari Azhar, the chairman of Indonesia's Corruption Eradication Commission, or KPK, was the alleged mastermind of a drive-by murder, it seemed outlandish. Since taking his position 17 months ago, the former prosecutor has developed a reputation for fearless probity.

The case has come to be seen as a gauge of just how far Indonesia has succeeded in building credible, professional institutions since the former dictator, Suharto, and his corruption-riddled system were toppled in 1998. The lurid scandal is worthy of the trashiest of airport novels. It hit the headlines on March 14th when the head of a state-owned pharmaceutical company was shot dead on his way home from playing golf. Such crimes are extremely rare in Indonesia. But public interest quickly waned as the killer's trail appeared to cool.

Then, late last month, Mr Antasari's name was connected to the case. Within four days he was detained. Police remain tight-lipped about the motive. But they acknowledge a key witness is a former golf caddie the murdered executive took as his third wife last year. Detectives say she is under their protection. They also remain silent on why, among eight others detained in the case, are a senior police officer and a newspaper proprietor. Mr Antasari has acknowledged knowing the dead executive but denied any involvement in the murder or having more than a brief acquaintance with the ex-caddie.

The good news for Indonesia is that the scandal appears to be unconnected to KPK business. There is also no suggestion yet that Mr Antasari has been framed by any of his enemies—and he can be assumed to have quite a few. The previous central-bank governor, a senior prosecutor and several legislators are among those he has successfully prosecuted.

The KPK has responded to his detention with admirable lack of fuss. The four deputy chiefs suspended their boss within hours of his being declared a suspect. It appears to be business as usual at the institution, with at least one high-profile indictment proceeding this week. Analysts say the scandal is a blow for the KPK but one from which it should recover quite quickly. President Susilo Bambang Yudhoyono, who faces re-election in two months, has also acted appropriately. The KPK is independent of the government but, somewhat unjustifiably, the president has gained kudos for its successes. He at once distanced himself from Mr Antasari, saying the law must take its course.

Parliament, which is deliberating legislation that would weaken the KPK, has also acted typically, if less commendably. Legislators have demanded that they immediately be given the right to appoint a new KPK chairman, even though the law governing the institution says no such step is required unless there is a conviction.

The police, however, have come out of this well, so far. They have much work still to do because few convictions seem likely on the basis of what is known to date. But at least they, like the other Indonesian institutions involved, are starting to function professionally. And the elite, it seems, is no longer above the law.

Singapore's NGO furore

Taken unawares

May 7th 2009 | SINGAPORE
From The Economist print edition

Liberals rally to take on the Christian right

A BLOODLESS coup instigated by a septuagenarian “feminist mentor”; a death threat sent to the new president’s husband by a self-proclaimed “jihadist sleeper”; a 3,000-person showdown. The tiny world of Singapore’s usually timid NGOs has never seen anything like it.

In late March a secretive group of conservative Chinese Christian ladies surreptitiously took over the executive council of AWARE (Association of Women for Action and Research), an advocacy group that has done much to promote women’s rights. Half of the new council attend the same church. They were jolted into action by AWARE’s alleged pro-gay agenda, particularly in sex-education courses taught at some schools. “Are we going to have an entire generation of lesbians?” bemoaned Thio Su Mien, their 71-year old matriarch.

Ms Thio’s disciples snatched control from a group of liberals who had served AWARE for years. The conservative new council and the liberal old guard traded barbs, exposing an ideological divide. Critics questioned the new lot’s shady tactics as well as their religious motives.

And so the old guard tabled a no-confidence motion, forcing an extraordinary general meeting. Ahead of it, politicians called for tolerance. And the new council’s pastor, Derek Hong, tried to mobilise support from the pulpit. Rebuked by leaders from a number of religions, he later apologised.

But the damage was done. At the meeting on May 2nd, the new council lost the vote and resigned. The question is why it staged the ill-fated raid in the first place. According to Alex Au, an online commentator, the Christian right will tend to use stealth to achieve its goals, because the discussion of religion is taboo in Singapore. They do not have well-established channels of discourse.

Yet the manner in which this conflict was resolved—through reasoned debate, without government intervention—is reason to cheer, says Braema Mathi, a former AWARE president. On May 7th, however, the government announced that AWARE’s programmes in schools did not conform in all respects to its guidelines and would be suspended.

Mr Au rejoices that the episode saw more people involve themselves in important issues. They are still, however, in a minority. In a survey, 70% of those polled said they did not care about what is going on at AWARE. But then, with Singapore’s trade-dependent economy facing its worst recession in history, most people have more prosaic worries.

Economist.com WORLD ASIA

South Australia's water shortage

In need of a miracle

May 7th 2009 | LANGHORNE CREEK
From The Economist print edition

To turn a drought into wine

EVER since they started pumping water for their vines, the winegrowers of Langhorne Creek have learnt to cope with crises. But none as grave as the one they face now. Their water source at the mouth of the Murray River, in South Australia, has turned salty. Adelaide, the state capital 55km (34 miles) away, has been told its water supply from the Murray can no longer be guaranteed. The Murray Darling Basin Authority, a new body charged with saving Australia's biggest river system from expiring, has its work cut out.

Early last month Rob Freeman, the authority's boss, delivered grim news. The volume of water flowing into the Murray and its main tributary, the Darling, between January and March was the lowest in 117 years. The three-year volume up to March was the driest ever. Mr Freeman told Adelaide's 1m people this meant that not enough water might be conveyed down the Murray to meet their "critical human needs" next year. Just 17 years ago, Adelaide relied on the Murray for only 10% of its water: regular rains filling dams in the city's hills provided the rest. Now, it depends on the Murray for 90%.

Climate change and Australia's worst drought in a century are partly to blame. But the river system that covers two-thirds of Australia's irrigated farming land is also suffering from decades of overuse. South Australians feel this with growing bitterness. They are at the end of the line in a system that starts about 2,700km north. The more populous states of Queensland and New South Wales (NSW) comprise four-fifths of the basin's area. Farmers, especially cotton and rice growers in those upstream states, account for 83% of the basin's consumed water. The impact of all this has left the Murray's mouth near Langhorne Creek close to ruin.

The wine region's first water came from an ancient aquifer. Too much pumping forced the authorities in the early 1990s to switch water licences to the Murray, 10km away at Alexandrina, one of two lakes at the mouth facing the Southern Ocean. Plenty of water then flowed through the basin to keep the lakes fresh. Langhorne Creek's wineries boomed. A crunch came last year. The flows stopped, and Alexandrina's level has dropped 1.5 metres. Its water is now too saline to use.

The authorities are now pondering the harsh step of building a weir at nearby Wellington to stop the salt water moving back into the Murray itself. Experts predict this would in effect destroy the lakes and their surrounding freshwater wetlands. Penny Wong, the federal minister for climate change and water, says the "unfortunate reality" of the flow figures means the option must be kept as a "last resort".

Growers at Langhorne Creek and nearby Currency Creek, meanwhile, have formed a company to build a pipeline to secure their water from a cleaner point on the Murray further east. They may yet survive. Australia's interstate water-trading scheme has allowed the state to buy water from distant farmers in NSW, who have switched to less thirsty crops, and keep it in store for Adelaide. Mr Freeman's body, launched by Canberra late last year, is the first with power to manage the entire river system, overriding rivalries between the four basin states, so that calamities such as Lake Alexandrina's don't happen.

Unless drought-breaking rains come, that will be a tough ask. Craig Willson, proprietor of Bremerton winery at Langhorne Creek, and a director of its pipeline company, reckons drought and loss of the lake's water have cut the region's productivity by almost 40% over the past two years. "Even so, we're surprised at how well some vines survive using less water," he says. Applied to growers of other crops, the same

lesson may help save the Murray.

Defending Australia

Sharpening the koala's claws

May 7th 2009 | SYDNEY
From The Economist print edition

Why, despite the slump, Australia wants to lavish money on its armed forces

FLANKED by Australia’s senior soldiers, Kevin Rudd, the prime minister, stood on a navy frigate in Sydney Harbour on May 2nd and talked of likely future tensions in Asia and the Pacific. He was launching Australia’s first defence white paper in almost a decade. The show of naval muscle was calculated. His government plans a military build-up over the next 20 years as a hedge against the tensions, which it worries are most likely to come from China.

There will be only a modest rise in the number of military personnel, of about 3,000 to 57,000. But the navy and air force will get the hardware to build what the paper calls a “heavier and more potent maritime force”. The submarine fleet will be replaced and doubled in size to 12. There will be a new fleet of 11 frigates and air-warfare destroyers, equipped, like the submarines, with cruise missiles. The air force will get about 100 new fighter-bombers. Mr Rudd calls the build-up “the most powerful, integrated and sophisticated set of military capabilities” Australia has had. It is estimated to cost around A$100 billion ($74 billion).

But what is it for? For most of its life, Australia has relied for its security on the naval presence in the Pacific region of first Britain then, since the second world war, America. The paper predicts that China’s rise as an economic and military giant could well end all that. It sees China as possibly becoming the world’s biggest economy by 2020. That, plus its military modernisation and the testing of America’s primacy, could give China’s regional neighbours “cause for concern”.

This implies China has now replaced Indonesia as the main strategic threat to Australia. But the paper talks only of a remote but plausible confrontation with “a major-power adversary”. The new hardware’s priority will be defending Australia’s northern approaches from the Indian Ocean via the Timor Sea to Polynesia. The American alliance will remain pivotal. But Australia will no longer put troops at risk “in distant theatres of war where we have no direct interests” (read Iraq, but perhaps not Afghanistan).

Self-reliance is one thing. How Australia’s region will respond to its apparent preoccupation with China as a possible future adversary is another. Mr Rudd seems keen not to let China’s status as Australia’s biggest trading partner override its security concerns. But Hugh White, a defence analyst, and an author of the last white paper in 2000, worries that this one lacks answers on how this can be achieved. “It’s reluctant to tell Australians that we have to think seriously about living in an Asia that will be very different from anything we have known,” he says.

Banyan

A watched frog never boils

May 7th 2009
From The Economist print edition

Peace is breaking out across the Taiwan Strait. Presumably, that is good for Taiwan

Illustration by M. Morgenstern

LOCAL gloom holds sway, from Pakistan to North Korea, in so many corners of Banyan's woods, and an economic pall hangs over nearly all. So it is nice to stumble into a sunlit clearing once in a while.

Taiwan is such a clearing, and the sunlight is its improving relationship with China. Ground-breaking recent agreements on cross-strait travel and investment promise profound consequences for Taiwan. And after a dozen failed attempts to join the World Health Organisation (WHO), Taiwan at last won China's agreement to be invited to the WHO's World Health Assembly this month, though merely as an observer.

President Ma Ying-jeou of the Kuomintang (KMT or Nationalist Party) has presided over the change. He came to office a year ago determined to alter the course of his predecessor, Chen Shui-bian of the Democratic Progressive Party (DPP). For eight years, Mr Chen aired his independence-minded views with increasing abandon. China seethed. It views Taiwan as the last unfinished bit of a civil war in which the Chinese Communist Party drove the KMT off the mainland in 1949. It promises war if Taiwan ever declares independence. The tensions were not all Mr Chen's doing, since China rebuffed early overtures. Still, by the end of Mr Chen's term, relations with the United States, Taiwan's protector, were badly strained, too. It was conceivable that Taiwanese provocation might drag America into a conflict with China, dashing hopes of an Asia-led 21st century.

Mr Ma promised a more conciliatory line. The WHO breakthrough is being celebrated in Taiwan as proof it is paying off. This will be the first delegation to represent Taiwan at a UN event since the island lost its seat to China in 1971. Cross-strait relations are the stuff of debate and disagreement, but most Taiwanese see the deal as gaining the kind of "international space" which China has long sought to constrict. Perhaps China reckoned that obstructing Taiwan did nothing for the image China is polishing for itself as a responsible global power. And without its long-planned gesture, progress on cross-strait ties would be harder. China's long-term strategy for Taiwan is sometimes likened to boiling a frog in water, over a flame so low the frog does not feel it. But first you have to get the frog to plop into the pan.

And so the cross-strait agreements may prove to be the more far-reaching for Taiwan. Direct flights will more than double, to 270 a week. The two sides agreed on a framework to allow financial firms to set up in each other's country. And Taiwan agreed to open up to Chinese investment. Until now Taiwan, which has up to $400 billion invested in China, allowed almost nothing in return, citing national security. Now,

both companies and fund-managers will be allowed in. Already, China Mobile's purchase at the end of April of a 12% stake in a Taiwanese telecoms firm, Far EasTone, marks the first big mainland investment in Taiwan since 1949, a harbinger of much more to come (see article).

Of the two sides, Taiwan stands to gain hugely more from all this. Its strengths are in fields such as electronics, information technology and biotechnology. Even with Chinese involvement, these industries will stay in Taiwan, for they depend on decent regulation and copyright protection, both lacking on the mainland. Meanwhile, top Taiwanese brands will get readier access to China's huge domestic market, so shielding Taiwan's exports somewhat from the vagaries of the global economy. More mainland Chinese visitors, already running at 3,000 a day, will be a boost to flagging tourism. (Hoteliers report that groups first lock themselves in their rooms, to gawp gobsmacked at politicians being insulted on television chat shows.) Recently a pariah among foreign investors because of poor cross-strait relations, Taiwan has suddenly become the only bull-market story in town.

For some in Taiwan, notably in the DPP, the risks are only beginning as China puts the pan on the heat. Deeper economic integration, they say, will dangerously narrow Taiwan's options as China moves towards the endgame of unification. Yet Mr Chen's tenure undermined these arguments. His legacy is very nearly destroyed. Family members have admitted to venality, and Mr Chen himself sits in jail accused of graft and embezzlement. On May 5th prosecutors filed yet more charges of bribe-taking and influence-peddling. The sanctimony of the KMT, once one of the world's most thuggish and corrupt political parties, but largely spared by the present judicial system, is grotesque. Yet Mr Chen and his approach are discredited, the DPP in tatters.

Enmeshing China too

So at least until 2012, the date of the next presidential election, Mr Ma and his colleagues will make the opposite case. The chairman of his Mainland Affairs Council, Lai Shin-yuan, says that economic integration will increase security by making Taiwan so valuable for China that it will think twice about jeopardising stability. Others argue that an unprovocative island more firmly enmeshed in the global economy will bring about greater American commitment. For now, the United States is delighted at the rapprochement, and at a Beijing-Taipei-Washington triangle that for once is pretty harmonious. Ms Lai promises a "diplomatic truce" with Beijing and an end to a costly (and losing) battle to win diplomatic recognition from tinpot countries. Nor, she says, will political showmanship play any part in Taiwan's participation in the WHO assembly.

Mr Ma, as it happens, tapped Ms Lai from the pro-independence movement, a sign of the constraints on his policy. Even if he does harbour longings for a closer eventual union with China, its Communist rulers view the 58-year-old upstart as a liberal with ugly habits: advocating human rights and trimming his sails to suit the Taiwanese majority. For now, at least, the desire of that majority is, overwhelmingly, to keep Taiwan's sovereign arrangements—independent in fact if not law—exactly as they are.

Correction: Johns Hopkins University

May 7th 2009
From The Economist print edition

Our article last week ("When the help dries up") on last year's cyclone in Myanmar claimed that a report by Johns Hopkins University in Baltimore had called for a moratorium on aid to victims of the cyclone. The report, which was written in collaboration with a group of Burmese aid workers, in fact called for aid to continue. An accompanying news release suggested a review before further assistance was delivered. We apologise for the error, which has been corrected online.

Sudan

Behind the defiance, a whirr of diplomacy

May 7th 2009
From The Economist print edition

President Omar al-Bashir growls at the West for wanting him tried for alleged war crimes in an international court. But diplomacy is intensifying behind the scenes

Reuters

TWO months after the International Criminal Court (ICC) at The Hague issued an arrest warrant for Sudan's president, Omar al-Bashir, for alleged war crimes in his country's battered western region of Darfur, he seems to be sitting pretty. He has remained entirely unapologetic for the deaths of some 300,000 of his compatriots. On the day the indictment was announced he expelled 13 Western aid agencies which had been trying to keep Darfur's 2.7m displaced people alive. He continues to denounce the court as a tool of Western neo-imperialism. He has gone on very public trips to friendly neighbouring countries, such as Egypt and Ethiopia. And he was hailed as a hero at a summit of the 22-country Arab League in Qatar, an ally of the West. In sum, he has demonstrated that the arm of the ICC's law is embarrassingly short.

But beneath the surface, things have been less simple, less predictable and less easy for Mr Bashir. Many expected his government to lash out at its enemies, real or imagined, even more fiercely. After its initial huff and puff, it has not done so. In truth, Sudan's rulers have been rattled by the indictment. As a result, they have been trying anew to ingratiate themselves with the West and with governments farther afield on a range of issues, all in the hope of persuading the UN Security Council to ask the ICC to suspend its indictment, which it has the power to do, for a year at a time. Despite the Sudanese government's defiant rhetoric and the expulsion of the aid agencies, it has quietly shifted on several points. It can change tack again, as it has before. But it is plainly not immovable.

For a start, a month after the expulsion of the aid agencies, Sudan's government announced it would honour its promise to hold a general election, albeit a bit later than expected, in February 2010. Under a Comprehensive Peace Agreement (CPA), signed in 2005 with former rebels in the south who had been fighting for autonomy or secession for most of the past four decades, nationwide elections were supposed to be held this year. Some opposition politicians expected the beleaguered Mr Bashir, enraged by the indictment, to junk the American-brokered CPA and to break his election promise. But his refusal to do so hints at a reluctance to burn all his diplomatic bridges with the West.

If all goes well, the elections will be the first fully democratic ones since 1986, three years before Mr Bashir came to power in a coup. There are still many pitfalls, not least the compilation of a voters' register that everyone can agree on. But assuming the poll is held, Mr Bashir and his National Congress Party might conceivably lose the presidency to Salva Kiir, the leader and likely candidate of the Sudan People's Liberation Movement, the southerners' former rebel group.

And there have been flickers of hope over Darfur itself. After the indictment, Mr Bashir's government and one of the biggest rebel groups in Darfur, the Justice and Equality Movement (JEM), broke off negotiations that had just begun, for the first time in years, in Qatar's capital, Doha. But those talks have lately resumed. It would be better if all the various Darfuri rebel factions were involved. But negotiating with the best-armed lot is better than nothing.

Hopes of a successful outcome were raised on May 3rd when the governments of Sudan and Chad, its western neighbour, agreed to normalise relations after talks brokered by Qatar and Libya. Chad's government has often stirred the pot in Darfur by arming and backing JEM.

This diplomatic spurt has been encouraged by America's new envoy to Sudan, an energetic former air-force general, Scott Gration, who has been advising Barack Obama on African affairs for several years. Unlike his two predecessors, Mr Gration has been appointed as a full-time envoy, stressing Mr Obama's eagerness to help make peace in Darfur. Mr Gration was born in Congo to missionary parents, speaks Swahili and knows the region well.

Above all, Sudan's government still craves normal diplomatic ties with America and yearns to be taken off the State Department's list of sponsors of terror. This is the West's strongest lever for persuading Mr Bashir to end his military campaign in Darfur and to meet his obligations under the CPA, such as holding elections.

All these initiatives may lead nowhere. Sudan has long seemed inclined to fragmentation and conflict. No sooner had Chad signed its latest pact with Sudan than it accused Mr Bashir's army of launching an attack across the border, which the Sudanese denied. By the same token, JEM was reluctant to attend the meeting in Qatar, but Mr Gration persuaded it to do so.

Since the turn of the year, fighting—between government forces and the rebels, and between tribes and rebel factions in the ravaged west—has been sporadic. Supplies of food and medicine left behind by the foreign agencies have nearly run out. But at least people are talking. And Sudan's prickly government is giving a little ground, despite—or perhaps even because of—that controversial ICC indictment.

Guinea's new leader

He sounds modest. But for how long?

May 7th 2009 | CONAKRY
From The Economist print edition

Don't expect the latest coup-leader to bow out in a hurry

Reuters

Big Dadis

ONLY its third fully-fledged head of state since it became independent half a century ago, Guinea's Moussa Dadis Camara is not the shy type. Having taken power in a bloodless coup after Lansana Conté died in December, he says he will organise elections and has rejected the temptation to promote himself from captain to general. But there the modesty ends and the Dadis Show, as Guineans call it, begins.

A cavalcade of cars and military vehicles, sometimes topped off by a helicopter, accompanies his every movement. Most strikingly, the captain personally interviews alleged drug dealers and corrupt politicians of the old regime, live on television. Ousmane Conté, a son of the previous president, was viewed confessing that he had been part of a drug-smuggling ring. Several former ministers and a prime minister have agreed to pay back money that went missing when they were in office.

These public grillings have made Dadis, as he is widely known, very popular. Recordings of his television triumphs are sold in markets. Transparency International, a Berlin-based lobby, deems Guinea one of the world's ten most corrupt countries; it is also one of the poorest. So graft-bashing gestures go down well.

When the captain seized power at the head of a scrum of soldiers, it was not immediately clear who was calling the shots. But he has begun impressively to fulfil his promises to clean up public life. "Corruption is widespread in Guinea, and in Conté's time we knew it started in the president's office," says Bakary Fofana, a civic leader. "And people at the very top were involved in the drug-trafficking too. Ousmane Conté's arrest showed that Dadis has the freedom to take on anyone."

Still, the actual figures of the dirty money due to be repaid have not been revealed; Mr Conté and others have yet to be tried in court. The junta arrested a handful of soldiers last month, accusing them of preparing a counter-coup. Divisions in the army present the biggest threat to stability.

Most Guineans seem to welcome the dynamic new regime. But life is still hard. After years of misrule, even basic necessities such as electricity and water are luxuries in Conakry, the capital. "Anyone who brings us regular power and water will be president for life," says Sekou Ahmed Cissokho, a journalist. "It's that simple!"

Dadis has promised proper elections, for the first time ever, by the end of the year. A transitional government has been appointed. But many of the ministers are in uniform, and the prime minister did not even have the privilege of announcing his cabinet; the names came straight from the armed forces. So far civil society, trade unions and a bevy of opposition parties say they are happy with the map charting the way towards elections, though some doubt the timetable can be met.

Foreign governments and international bodies will be expected to pay for the polls, an expensive business. Whether the captain will run is another hot issue. Apparently off the cuff, he recently said he was a citizen like any other and could take off his uniform to stand for election. He retracted the remark after a public outcry made it clear that Guineans do not fancy another long spell of military rule following 24 years of Lansana Conté. But the captain was plainly floating his balloon.

Tanzania

Waiting for that great leap forward

May 7th 2009 | DAR ES SALAAM
From The Economist print edition

Worries about one of east Africa's steadier economies

THE country already gets 40% of its government budget in aid, but now it wants even more foreign cash to help it through the economic downturn. How much is enough? Tanzania's president, Jakaya Kikwete, smiles grimly. "We're trying to bring down our dependency, but we're grateful for what we receive."

With 44m people, Tanzania has often been given the benefit of the doubt simply for being the gentler twin of harsher Kenya, which has 40m. What it lacks in dynamism it makes up for in placidity and a common national identity. It is unlikely to fall apart at elections or any other time.

Its founding party of independence, Chama Cha Mapinduzi (CCM, the Party of the Revolution), formerly the Tanzanian African National Union, known as TANU, still suffocates the country's ragtag opposition parties with its size and ponderous propaganda. Mr Kikwete is a CCM man; his breakthrough job was as the youthful head of political indoctrination for Tanzania's armed forces. He will almost certainly be returned to office with a big majority in elections next year. He still charms would-be investors with his sales patter.

Yet those who set up shop in the country are often disappointed. Tanzania, many complain, is a "slow" or even "terrible" place to do business—and "ungrateful" for foreign aid or investment. Even its boosters admit it is wrapped in red tape and lacks skilled workers. Almost everyone says Mr Kikwete is spending too much time burnishing Tanzania's image abroad and not enough fixing problems at home. Last year he chaired the African Union.

In any event, he hopes that aid will keep Tanzania afloat long enough for its economy eventually to make a great leap forward. Shiny new buildings even in provincial towns, along with new roads and water projects, signal optimism. Politics are stable. A rowdy separatist movement in the island of Zanzibar is quiet for now.

By Tanzanian standards there is a new sense of urgency. The energy ministry says it wants tenders "immediately" for a power station to cover a paralysing shortfall in electricity. Mr Kikwete turns up unannounced at state-owned outfits such as the port and the railways to demand efficiency and rail against corruption. He has also lambasted the country's "Wabenzi" (those who drive a Mercedes-Benz).

But Mr Kikwete turns mournful when he spells out the effects of the global recession: missed government revenue targets; a cancelled sovereign-bond issue; projects for a nickel plant and a vast aluminium smelter put on hold; revenue from coffee down; cotton hit even harder; tourism suffering as well. An exception is gold, with new finds still to be exploited and the price holding up fairly well.

Tanzania may already, in some respects, be falling behind. A recent Chinese state visit failed to bring much investment. The government in Beijing thinks Kenya, not Tanzania, is the gateway to the mineral wealth of Congo. Tanzania's two main railways are rickety. The port of Dar es Salaam failed to pinch business from Kenya's port, Mombasa, when Kenya was in turmoil a year ago. No one seems to know how Tanzania's main port will hit its target of a tenfold increase in goods traffic by 2030. Tanzania is not even spending all the aid it is given. Last year, $2.4 billion of pledged funds were not disbursed.

Tanzania must also decide whether to integrate more closely into the East African Community (EAC), which includes neighbouring Burundi, Kenya, Rwanda and Uganda. It has dragged its feet over opening its borders and moving towards a common currency, though it recently insisted that a common market would get going next year. It suspects Kenya of using the EAC as a way of grabbing arable Tanzanian land on the cheap. And the country's tiny middle class fears being swamped in a common market by better-qualified Kenyans and Ugandans. Moreover, the world crisis may bolster old socialists in the CCM who want a return to *ujamaa*, a failed model of rural collectivisation propounded by Tanzania's founding president, Julius Nyerere. That would set it back even further.

Prisoners in Iraq

Hope for the best when they go free

May 7th 2009 | BAGHDAD
From The Economist print edition

Thousands of Iraqis are being released from detention into an uncertain future

WITH too little evidence to hold them for longer with a view to prosecution, thousands of detainees in American custody in Iraq are being freed, just when fears are rising that the country's smouldering insurgency could reignite. In the past few weeks, a rash of suicide bombs have killed several hundred Iraqis, making April the bloodiest month this year and reminding everyone that, despite a dramatic improvement in security, Iraq is still a dangerous place. One fear is that the newly freed men could return to battle. Several Iraqi intelligence officers have said that many have already done so—and are responsible for the recent spike in violence.

Not so, say hopeful American prison officials. Vocational programmes in the detention camps should, they insist, ensure that most of those set free find peaceful things to do. If not, Iraq's forces are now much better able to handle troublemakers.

The biggest American detention place has been Camp Bucca, named after a New York fireman who died in the attacks on September 11th, 2001. At its fullest, the camp, near Iraq's border with Kuwait, held 26,000 Iraqis. This year the number has dipped from around 22,000 to less than 7,400. Those still inside will be released or gradually handed over to Iraq's authorities as part of a security agreement between the governments in Baghdad and Washington that came into force on January 1st. Iraqi officials will assess each detainee's case. A hundred-odd remain on death row, having been sentenced in Iraqi courts.

The handover-cum-release of the detainees is a tricky part of the Americans' exit strategy, stirring strong emotions. Many Iraqis think the detainees, in their distinctive yellow jumpsuits, have done nothing wrong. American commanders say most are guilty of something. In any case, most of the men held at Camp Bucca will walk free because the intelligence-based suspicions that often resulted in their arrests have not provided evidence that would stand up in court. The same goes for many of the 3,400 prisoners at Camp Cropper, near Baghdad, where Saddam Hussein was held and executed. Another 1,100, at last count, were being held at Taji, north of Baghdad.

Until this year, American forces were operating in conditions of war: they could pick people up on suspicion of being a security threat without solid proof. But prosecutors need two witness statements or a confession to secure a conviction. At least 85,000 people held at one time or another since American-led forces invaded six years ago had been freed before the security accord took effect.

Reuters

How many back to the battlefield?

It is hard to tell how many former detainees are being rearrested and imprisoned again by Iraq's own security forces. Quite a few are known to have been sent recently to Camp Cropper. The 2,000 most dangerous men in American detention, such as suspected senior members of al-Qaeda's Iraqi branch and of the militia known as the Mahdi Army that is loyal to a radical cleric, Muqtada al-Sadr, will be held longest. Each of these detainees is supposed to appear before a judge within a year, giving both the American and Iraqi authorities time to build cases that may secure convictions and terms in prison.

But most of the other 10,000 or so men still behind bars are low-level insurgents, many of them motivated by money as much as belief. Between a third and a half of those in Camp Bucca chose to take part in reading and writing classes or to learn to sew and paint and so on. But it is too soon to say whether most of them will follow a peaceful path once released.

The future may be shakier still for those who get transferred by the

Americans to one of the nine approved Iraqi prisons. Cases often take months to come to court. Corruption is rife, with reports of inmates being freed after bribing their guards. Several prisons have notoriously bad human-rights records. In truth, what happens once the detainees are out of American hands, whether they are set free or switched to an Iraqi jail, is anyone's guess.

Iran's presidential race

How popular is the populist?

May 7th 2009
From The Economist print edition

Mahmoud Ahmadinejad may have put his foot in it once too often

WHEN Iran's president, Mahmoud Ahmadinejad, came home from speaking at a UN conference on racism in Geneva last month, state television beamed images of a cheering crowd that turned out to greet him. A foreign-ministry statement trumpeted his performance—including a speech that termed Zionism a form of racism deserving of eradication, which sparked a walk-out by many delegates—as an example of Iran's brilliant diplomacy.

Yet such official adulation looks increasingly at odds with public sentiment. Since winning office in 2005, Iran's rabble-rousing president has always been controversial. Now, with the first round of a presidential poll due in five weeks and campaigning in full swing, his rival candidates are saying things aloud that Iranians have been more used to hearing in whispers.

"The president's speeches have harmed Iran's interests," is the blunt opinion of Mehdi Karroubi, a senior reformist cleric whose campaign slogan is simply "change". Referring to Mr Ahmadinejad's vocal scepticism about the historical reality of the Holocaust, Mr Karroubi declares it of no concern to Iran whether the mass murder of European Jews took place or not. Harping on the issue merely provokes hostility, he says, insisting that if he were in charge, improving relations with the West would be a priority.

The other leading reformist challenger, Mir Hosein Mousavi, a former prime minister, has attacked Mr Ahmadinejad's adventurism in foreign affairs and acidly calls for a "return to rationality". Mohsen Rezaie, a former commander of the Revolutionary Guards and the strongest claimant to emerge from the incumbent's own extreme-right corner, gives warning even more darkly that unless he is unseated Mr Ahmadinejad will "drag Iran over a cliff".

The candidates have been equally outspoken on domestic issues. Mr Mousavi says he supports the release of campaigners who have been imprisoned for demanding freedoms. Addressing the concerns of youths who chafe at the stricter imposition of Islamic rules under Mr Ahmadinejad, he vows to disband the Guidance Patrols that harass and arrest people accused of immodest behaviour. Mr Karroubi has even challenged his fellow clerics who run Iran's courts, sharply attacking those who sentence under-aged offenders to death.

Seen as threatening by self-professed guardians of the Islamic Revolution, such pronouncements have prompted some conservatives to rally around Mr Ahmadinejad. In late April, a coalition of 14 groups describing themselves as "principlists" declared their backing for him. Their move was widely interpreted as an endorsement of the incumbent by Iran's supreme leader, Ayatollah Ali Khamenei.

Yet even Mr Khamenei, who has long subtly promoted Mr Ahmadinejad while feigning a regal distance from the political fray, is signalling doubts about his protégé. Recently he took the unusual step of publicly scolding the president for daring to fire a loyalist cleric who ran the state bureau charged with managing the pilgrimage to Mecca. Taking notice of his shrinking credit, Mr Ahmadinejad cancelled a scheduled South American tour.

His worry is understandable. Poorer Iranians may admire their president's folksy moral grandstanding, be impressed by the bear-hugs he receives from the leaders of Cuba and Venezuela, and certainly welcome the generous handouts he has dispensed on the no fewer than 58 provincial tours he has undertaken. But their urban and better-educated compatriots tend towards greater scepticism. With inflation running at around 25% and a sharp fall in receipts from oil exports generating a rapid slump in industrial investment, construction and employment, they suspect that Mr Ahmadinejad's populist policies may have irretrievably squandered the unprecedented $300 billion windfall in oil revenue that Iran earned during his four years in power.

Yet despite broadening discontent with his rule, the president retains strong cards. His core of supporters is more likely to vote than their critics, many of whom yearn for far deeper reforms than even reformist candidates are proposing. Besides, Mr Khamenei, who controls the state media, the courts and zealous paramilitary groups, is widely believed to prefer continuity to change in foreign affairs. This may be particularly true as Iran struggles to find a response to diplomatic overtures from Barack Obama's administration, which has declared a willingness to turn a new page in America's long-fraught relations with the Islamic Republic, while continuing to press Iran to curb its nuclear ambitions.

"Letting the world know we are willing to engage", said America's secretary of state, Hillary Clinton, in recent testimony before Congress, "will give us a stronger hand in getting leverage on them when it comes to tough, crippling sanctions." In the eyes of Iran's hardliners, this looks suspiciously like a fuzzier version of the carrot-and-stick tactic used by George Bush's reviled administration. Perhaps, say some observers, this is why they have sought to up the ante by, for instance, having a revolutionary court sentence Roxana Saberi, a 32-year-old Iranian-American journalist, to eight years in prison for allegedly spying against the Islamic Republic.

Egypt's pigs

What a waste

May 7th 2009 | CAIRO
From The Economist print edition

Is it wise to kill the capital's rubbish-ridding pigs?

IN A city not much noted for efficiency, Cairo's traditional rubbish collectors, or Zabbaleen, have long been something of a paragon. While failing to keep Egypt's teeming capital very clean, the Zabbaleen, nearly all of them members of Egypt's 6m-plus Coptic Christian minority, do an excellent job of processing waste. Trucking refuse to the half-dozen rag-picking settlements that ring the city, they carefully sift out recyclable glass, paper and plastic. The rest is fed to pigs.

But in response to the global threat of swine flu, Egypt's government has decreed that the pigs, perhaps 250,000 of them, must go. Teams of surgical-mask-wearing pig-hunters were met at first with a barrage of rocks, bottles and manure hurled by the angry Zabbaleen. Now, backed by riot police and promising compensation, they are systematically hauling the beasts off for slaughter, a process expected to take several months.

With no cases of swine flu reported in Egypt to date, officials from both the UN and the World Health Organisation have condemned Egypt's porcicide as a drastic overreaction. Some disgruntled Copts, who have long complained of petty discrimination and fear the influence of Islamist groups such as the Muslim Brotherhood, say the move unfairly targets them. Others, noting that Egypt's minister of health consulted Coptic clergy before announcing the cull, see it as a plot by wealthy businessmen to uproot the Zabbaleen and seize their valuable land on the edge of the city. Still more rumours explain the government's swinophobia as a ploy to distract attention from other failings, such as not paying a promised salary bonus.

Yet most of the 80m-odd Egyptians seem relieved. While Muslims shun pigs as ritually unclean, many Copts also fear them as disease-carriers, with panic over swine flu heightened as Egypt has suffered at least 26 deaths from avian flu since 2006, the most in any country outside Asia. Besides, the crowded pig pens, surrounded by mounds of self-combusting biodegradable slime and hemmed in by dense human settlement, are a stinky eyesore. But the question no one seems to ask is, if pigs are no longer there to munch away at them, where will Cairo's giant piles of leftovers go?

Germany's economy

The export model sputters

May 7th 2009 | BERLIN
From The Economist print edition

The German habit of relying on export-led growth comes under fire

Illustration by S. Kambayashi

IT HAD been purring along nicely, handling the twists and turns of the world economy, powering past rivals, inspiring envy. But in recession Germany's export-led model is sputtering more than most. The European Commission now expects German output to shrink by 5.4% this year, compared with a 4% drop in the European Union overall; the German government predicts a 6% plunge. Most of the contraction will be in exports.

Countries with similar models are thinking of trading them in. It is "no longer realistic to hope that Japan's growth can come back just by exporting the same products," the Japanese prime minister, Taro Aso, told *Handelsblatt* newspaper. Philipp Hildebrand, president of Switzerland's central bank, expressed similar doubts. Germany's economic press is peppered with articles asserting that the country "needs a new business model".

Most German leaders disagree. The two main parties in the grand coalition, Chancellor Angela Merkel's Christian Democratic Union (CDU) and the Social Democratic Party (SPD), are sniping before the federal election in September, but they are united in believing that exports must remain the foundation of German prosperity. Germany, unlike other rich countries, has avoided deindustrialisation, they point out. With a rapidly ageing population, it is also right to accumulate savings by running a current-account surplus. Its scant natural resources and tradition of openness point the economy towards trade. Besides, Germany just isn't that into services, which have displaced industry in other countries.

This model could now change in one of three ways. The government could pursue an industrial policy that favoured production for the home market. To most Germans that would seem bizarre, though there is scope for creating service jobs in education or care for the elderly. Or the government could promote consumption by keeping fiscal policy relatively loose. But given German allergy to debt that is unlikely. Or change could come through a slowdown in world trade and a correction of international imbalances. This seems by far the most likely course. Germany will not deliberately surrender its position as the world's top exporter of goods, says Bert Rürup, a former head of the government's committee of economic "wise men" now at AWD Holding, a financial-advice firm. But its current-account surplus may fall as profligates like the United States and Britain consume less and export more.

Germany is export champion largely because it has done many things right. After losing competitiveness for years, industry clawed it back by holding down wage rises and shifting some production abroad. Germany now has “the lowest increase in unit labour costs of all its main trading partners,” says Mr Rürup. The previous SPD-Green coalition sought to reduce joblessness by trimming unemployment benefits and deregulating the labour market. Its successor has slashed the budget deficit, partly by increasing value-added tax by three points. German consumers stayed thrifty as consumers from San Sebastián to San Francisco binged on debt.

The result of this self-restraint was that exports soared in real terms, whereas consumer spending barely budged (see chart). Between 2004 and 2007 net exports accounted for 60% of growth. Germany’s current-account surplus reached a hefty 6% of GDP last year, irritating its trading partners within the euro area, which have been unwilling to hold down wages but can no longer resort to devaluation. Rather like China and Japan, virtuous Germany has made its living out of the overindulgence of others.

That was not a worry when times were good, but it is now. Exports will fall by nearly 19% this year, according to government forecasters. Germany’s debt-free households, by contrast, will cut spending by just 0.1%. The export-led recession has hurt its most prosperous regions and better-paid workers, which may be one reason why the public outcry has been muted. But recovery will not be quick. Some international trade “will disappear forever,” says Marek Belka, director of the IMF’s European department. Vehicles, machinery and chemicals account for nearly two-thirds of exports, a narrow base for the prosperity of the world’s fourth-largest economy. Vehicle manufacturing is highly vulnerable. Too many factories and workers are making too many cars globally; Germany will surely be forced to close down some production.

When recovery comes, consumption is likely to play a bigger part than exports. By 2013, net exports will account for 3.25% of GDP, down from 6.3% in 2008, says a forecast by eight economic institutes. Consumer spending, meanwhile, will rise from 56.3% of GDP to 57.75%. This shift will occur amid sluggish growth and lower employment: the trend rate of growth between 2008 and 2013 will be 0.9%, compared with average growth of 1.5% in 1995-2008, say the institutes.

Do not expect the government to encourage the change, however. Even as they battle to save carmakers like Opel, the German arm of General Motors, politicians dream of the world champions that may replace them. The SPD’s campaign programme rhapsodises about “climate and environmental technology” in which Germany supposedly has a competitive edge. IW Consult, part of the business-friendly Cologne Institute of the German Economy, thinks the growth industries will be pharmaceuticals, measurement technology and business services.

A government worried that growth is skewed towards exports could redress the balance by cutting taxes or raising spending. Dirk Schumacher, an economist at Goldman Sachs, says that the rise in VAT was a “big policy mistake” that squeezed consumption and also helped to undermine support for further economic reforms. He thinks the government should give low- and middle-income earners extra tax relief, even after the economy starts to recover. Ms Merkel may yield to pressure from the CDU’s liberal wing to make this the centrepiece of her election platform.

In the end, fiscal prudence will win out. The contraction of GDP plus the government’s two fiscal-stimulus packages will push the budget from balance in 2008 to a deficit of nearly 6% of GDP in 2010. The next government is likely to want to pare that back. Both governing parties back an amendment to the constitution to bar the federal government from running big deficits in most circumstances (and state governments from incurring any at all) after 2016. Tax will not be cut as a share of GDP, predicts Mr Rürup. The title of export champion may have lost its glitter, but Germany will not give it up lightly.

Silvio Berlusconi's divorce

Put asunder

May 7th 2009 | ROME
From The Economist print edition

Divorce could yet do political damage to Italy’s prime minister

Reuters

An on-screen relationship switches off

JUST when it seemed that nothing could touch him, Silvio Berlusconi faces the biggest obstacle to be put in his way since he returned to the job of Italian prime minister a year ago. It was placed there by his wife, Miriam Bartolini (known by her former stage name of Veronica Lario), who on May 3rd let it be known that she wanted a divorce because of Mr Berlusconi’s behaviour with other women. Ms Lario, his second wife, censured her husband on two counts. She described as “shameless trash” his reported plan to put up various showgirls as candidates for his party, the People of Freedom, at next month’s European election. And she deplored his presence at the 18th-birthday party of an aspiring model and actress, declaring that she could no longer be married to a man “who consorts with minors”.

Mr Berlusconi claimed that there was a link between his marital crisis and his recent success (including a 56% approval rating, despite the recession). He said his wife had been duped by media reports engineered by his opponents—a claim the main opposition leader, Dario Franceschini of the Democratic Party, called “pathetic”. But the mutual recrimination between the two leaders was not the only thing to give this otherwise private matter a political dimension.

The conventional wisdom is that Italians do not care about what their politicians do in private. But quite a few pay attention to what their church says. On May 5th the newspaper of the Catholic bishops’ conference openly criticised Mr Berlusconi, declaring that the “human fabric” of which a leader was made was “not irrelevant”. The next day, a Vatican cardinal said that the prime minister’s behaviour “seems strange to us—over the top.” Another danger for Mr Berlusconi is that, if his divorce is protracted, Italians will take sides, and some of his female followers will sympathise with his wife, particularly since she claims to have been publicly humiliated by him.

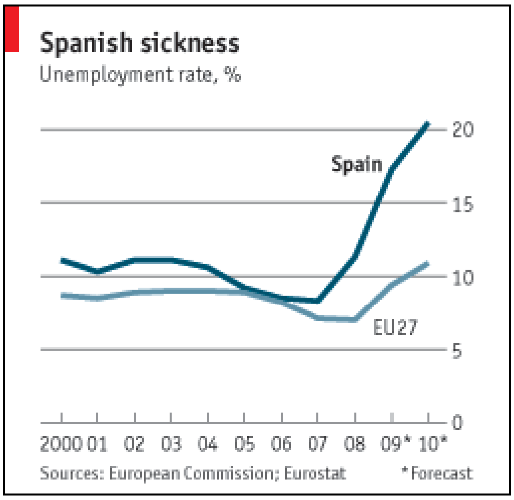
To a greater extent than any other European leader, moreover, Mr Berlusconi has built his political career on his life and lifestyle. He has forged the image of a virtual Superman, enjoying wealth, power and the love and loyalty of a beautiful wife even as he also enjoyed the company of an endless stream of pretty girls. Ms Lario has shown that, in one area at least, that image is false. And feet of clay do not become him.

Unemployment in Spain

Not working

May 7th 2009 | MADRID
From The Economist print edition

Spain is experiencing Europe's worst unemployment problem



THE huge signs are up in town squares, city parks and myriad spots where men in overalls dig holes, lay pavements or spruce up public facilities. They proclaim that the work is being paid for by Plan E, the stimulus package pushed through by Spain's Socialist prime minister, José Luis Rodríguez Zapatero. This included €8 billion ($11 billion) for immediate spending by town halls.

Plan E was meant to keep Spaniards working. Yet the latest unemployment figures show that it is not enough. In April 40,000 more people joined the dole queues. That was a slower rise than in previous months, but it still leaves Spain with a 17.4% unemployment rate, the highest in the European Union and twice the EU average. The European Commission predicts that unemployment will hit 20.5% next year. It also says Spain will struggle longer than other countries to recover, getting into positive growth only in 2011, a full year after the EU as a whole. "The sick man of Europe" was how the pro-government *El País* newspaper greeted the news.

Perhaps the most worrying thing is that Plan E has, in part, worked. The government says it has created some 280,000 jobs, even if few are permanent. The effect is temporary, said Pablo Vázquez of the Foundation for Applied Economic Studies. In August and September unemployment may climb again. Spain is lucky that strong social networks (helped by the black economy) help to prevent civil unrest.

The economy is in a double bind. It has been engulfed, like the rest of the world, by recession and shrinking global trade. To this is added Spain's own particular crisis, as a model based on cheap labour and a dizzy property market hits the skids. Economists say that Spain must now make the sacrifices and take the tough decisions that it avoided during the long boom years.

Labour-market reform is perhaps the toughest of all. In some ways Spain's labour laws are quite flexible. With almost a third of the workforce on temporary contracts, marginal workers are easy to shed by the simple expedient of not renewing contracts. That explains why Spain accounts for over half the additional unemployment within the euro area in the past year. The rest of the workforce is on Teflon-coated permanent contracts that make people difficult and expensive to sack. Companies inevitably choose staff to shed on the basis of how easy they are to fire.

Almost everyone favours reform. Such an initiative is urgently needed, with the government leading it, said a group of 95 academic economists in a letter. Mr Zapatero, however, does not share their sense of urgency. And labour-market reforms are not all that he is shying away from. The Bank of Spain recently issued a warning about a dwindling pension pot, suggesting it was time to push the retirement age above 65. Liberalisation of services provided by everyone from notaries and lawyers to veterinarians would help the recovery, said José Carlos Diez of Intermoney, a consultancy. "Whenever we have had a liberalisation plan, the economy has shown its potential for growth," he added.

So why does Mr Zapatero not reform? Besides all the usual worries about strikes, trade unions and public support, his main problem lies in parliament. Last month his minority government lost its first parliamentary vote. Although the Socialists are only seven seats short of an absolute majority, they are struggling to find allies. Basque nationalist deputies are angry that a Socialist, Patxi Lopez, has just become their region's premier. Catalan nationalists are similarly tired of the Socialist-led administration in their region. A fractious group of left-wing parties is not always reliable and unlikely to back tough reforms.

That leaves the main opposition, the conservative People's Party, which now leads in the opinion polls. Some Spaniards would like to see the two big parties push a reform agenda through together. Things will have to get much worse before they are ready to do that.

Russia and its near abroad

Neighbourhood watching

May 7th 2009 | MOSCOW
From The Economist print edition

Trouble in Georgia and a pow-wow in Prague point to new east-west tensions

PRECISELY what happened behind the barrack gates of a Georgian tank battalion near Tbilisi on May 5th is unclear. The Georgians say they quelled a mutiny and foiled a conspiracy to overthrow President Mikheil Saakashvili, probably inspired by Russian intelligence. Russia, predictably, denied involvement. Then on May 7th protesters from Georgia's opposition, who have been demanding Mr Saakashvili's resignation, clashed with police in Tbilisi in the first outbreak of violence since their demonstrations began in early April.

It is clear that Georgia remains extremely tense. Any provocation could easily become a pretext for renewed conflict. Both Russia and Georgia were quick to link the mutiny to NATO exercises that started in Georgia on May 6th. Georgia said it was a bid to derail the exercises, Russia that it was proof of NATO's folly. Holding the exercises in a psychiatric hospital would be more appropriate than holding them on the territory of the Georgian state, thundered Dmitry Rogozin, Russia's irascible NATO ambassador.

In fact NATO's small exercises were held under its Partnership for Peace programme and planned before last August's war in Georgia. Russia was even invited to participate. Dmitry Medvedev, the Russian president, still called the exercises a provocation. The Russians were also miffed by the expulsion of two Russian diplomats from NATO on suspicion of spying, especially since one of them, Vasily Chizhov, is the son of Russia's ambassador to the EU. In a tit-for-tat, Moscow kicked out two NATO envoys from Canada and pulled out of a NATO-Russia council meeting in Brussels. (Georgia also arrested its former envoy to NATO on spying charges.)

After Mr Medvedev's relatively amicable meeting with Barack Obama a month ago, NATO's actions have caused confusion in Moscow, says Dmitri Trenin, director of the Carnegie Moscow Centre. Is America serious about improving relations with Russia? Yet this confusion betrays a conviction that any improvement must come from America, leaving Russia free to interfere in its neighbourhood. Even as it complained about NATO's exercises, Russia was deploying border guards in South Ossetia and Abkhazia. In early April Georgia detected a build-up of Russian troops and equipment in the two breakaway regions. The Russians, however, said this was merely a military exercise.

Pavel Felgenhauer, an independent military analyst who accurately predicted Russia's war with Georgia in August, says that Russia's troops are still poised for action. The proponents of war, he argues, feel that the West's reaction to the 2008 war was meek. They also note that, despite being called a political corpse by Mr Medvedev, Mr Saakashvili has survived.

Fears of Russia weighed heavily on the minds of those who went to Prague this week to launch the "eastern partnership", a project meant to improve economic and political relations between the European Union and six former Soviet republics: Ukraine, Moldova, Georgia, Armenia, Azerbaijan and Belarus. This low-budget project has no military component and may not make much of a difference, says Fyodor Lukyanov, a Russian foreign-policy pundit. Still, Russia sees the EU as a competitor in its sphere of influence and reacts fiercely to any interference, such as Belarus being told that recognising South Ossetia and Abkhazia would hurt its prospects with the EU. That the summit was followed by a conference on Nabucco, a gas pipeline meant to bypass Russia in the south, was just another irritation.

Some would like the countries in the eastern partnership to choose between Russia and the EU, said Russia's foreign minister, Sergei Lavrov, on the eve of the Prague meeting. "We hope…there are no attempts at creating new dividing lines," he added. Yet drawing new lines is exactly what Russia has done in South Ossetia and Abkhazia. It is no surprise that Russia's idea of a second Europe centred on Moscow has little appeal to former Soviet republics. Unless the EU can offer tangible benefits to its new partners, however, its own appeal could also quickly wear out.

Charlemagne

An unloved parliament

May 7th 2009
From The Economist print edition

Why voters are not interested in the forthcoming European elections

Illustration by Peter Schrank

ON BILLBOARDS across Europe, blue posters have popped up alerting citizens to the forthcoming elections to the European Parliament. The posters, parliament's own initiative, make a reasonable stab at a hard task: explaining what is at stake when voters go to the polls between June 4th and 7th. Nobody wins or loses a European election. Instead, the outcome fixes the relative weights of the biggest political blocks, which range from a mushy centre-right to a squishy centre-left, with a woolly Liberal coalition in the middle. One poster asks "How much should we tame financial markets?" and pictures a fierce lion next to a winsome cat. Yet the balanced nature of the image is not quite right. Members of the European Parliament (MEPs) love regulating things: most would like the markets domesticated, and some want them spayed and declawed as well.

The posters seem sure to fail in their main aim: persuading Europeans to vote. Average turnout has fallen in every election, from 63% in 1979 to 46% in 2004, even though the parliament's importance has grown. It will gain still more powers if the Lisbon treaty comes into force next year. Yet a recent Eurobarometer poll found that just 34% are likely to vote this time (and previous such polls have overestimated turnout).

Frank-Walter Steinmeier, the German foreign minister, declared last month that turnout would "depend largely on how positively we speak about Europe and the reform process" in the new treaty. Alas, such high-minded talk is undermined by the election posters hung from every second Berlin lamppost by his own Social Democrats. These depict the Free Democrats as grinning "financial sharks", the Left Party as hairdryers blowing hot air and the Christian Democrats as "wage crushers", symbolised by a wilting coin. They do not mention the Lisbon treaty.

Other leaders decry the practice of packing the European Parliament with failed politicians and cronies. France must "send its best" to Europe, pledged President Nicolas Sarkozy. Once elected, MEPs should serve out their full terms, he added. Yet Michel Barnier, running the European campaign for Mr Sarkozy's ruling UMP party, is not expected to take up his seat. He is a figurehead who hopes instead to be picked as France's next European commissioner. Another top UMP candidate, Rachida Dati, is being sent to Strasbourg in disgrace after failing as justice minister. The French Socialist Party is as bad, handing safe spots on its list to figures from all its factions, regardless of merit. Both parties have dumped hard-working current MEPs for party barons.

In Italy, Silvio Berlusconi was widely reported to have chosen eight models and soap-opera actresses to

run for his People of Freedom party. His wife called the idea “shameless” (he now says it was never his plan). In the end, he chose a single ex-beauty queen to run, while accusing other parties of favouring “smelly” and “badly dressed” candidates. In Britain, the opposition Conservatives base their campaign on a demand that the Labour government hold a referendum on the Lisbon treaty. The campaign is in reality about the next general election: MEPs have no powers over national referendums.

Ask MEPs to explain the voters’ indifference and they often mention such national antics. More and more, complains a leading German MEP, national politicians “resolve their domestic disputes by sending people to the European Parliament who know nothing about Europe.” A senior Belgian sighs that the work of MEPs rarely interests the press. National politics are full of “personalities”, he explains. But the real work of the European Parliament is carried out in its committees. Its debates, in which many speeches are limited to 60 seconds, are a “series of monologues”. Lots of MEPs grumble that the press is obsessed with scandals over parliamentary expenses or perks (which, they hasten to add, happen everywhere).

There are structural reasons why European elections do not thrill voters from such countries as Britain, France and Spain, where elections can turn out governments overnight. To draw an economic analogy, the House of Commons is a free-market body, in which winners take all, brilliant speeches can make careers and power can shift with brutal speed. The European Parliament is a corporatist assembly, in which big parties rule by consensus and horse-trading, office is awarded by rotation and grandees have safe berths. Enoch Powell, a British politician, used to say that all political lives end in failure. In the European Parliament political lives end in the constitutional-affairs committee.

Worse than dull

But the parliament is worse than dull: it does not work properly. Like a student union, only with better expenses, it spends an inordinate amount of time on subjects way outside its mandate, such as foreign policy and defence. Its views can betray an undergraduate lack of realism: in the words of one Brussels diplomat, “that place is one big fucking NGO.” And its members can be loopily intolerant of dissent. At one Brussels dinner, Charlemagne heard MEPs howling “make him stop”, when a British Conservative ventured to suggest that the single currency might fall apart.

Funnily enough, Eurosceptics and federalists are often the parliament’s clearest-eyed analysts. “Very few members give the impression that this place is their life,” laments Daniel Cohn-Bendit, a Franco-German Green. He would like to see a third of the parliament’s members elected on pan-European lists, to create a “European public space”. It is hard to see that working: it would mean campaigning in 23 languages and 27 countries, all with different political cultures. To Eurosceptics, the answer is instead to return more powers to national parliaments. Both federalists and sceptics agree on one thing, though: the present set-up lacks legitimacy. They are right.

Economist.com / blogs / charlemagne

Gordon Brown

A hunted man

May 7th 2009
From The Economist print edition

Why the prime minister will probably limp through to the election

Getty Images

RARELY in his troubled premiership has Gordon Brown looked likely to win the next general election, which many expect to take place on May 6th 2010. He is now preoccupied with surviving long enough to contest it. The transient fillip to his popularity from the G20 summit he hosted in April has given way to unceasing woe: a budget that exposed Britain's fiscal crisis; an embarrassing YouTube appearance to promote parliamentary reforms that have since unravelled; and a tin-eared denial of settlement rights to long-retired Gurkhas, the Nepali soldiers who serve Britain, that led to Mr Brown's first defeat in the House of Commons.

The recession was already sinking the Labour Party in the opinion polls, all of which give the Conservatives a double-digit lead. But the recent calamities have stoked internal criticism of Mr Brown too. Former cabinet members, such as the long-aggrieved Charles Clarke and the stalwart David Blunkett, have publicly deplored his performance. Worse, one current cabinet colleague, Hazel Blears, codedly rebuked him in print, and others have had to deny that they plan to challenge him for leadership of the party in the coming months. The many would-be backers of Alan Johnson, the genial health secretary feared by some Tories, think he could lead Labour to modest defeat next year rather than the landslide loss they expect under Mr Brown. (That they only perfunctorily entertain the prospect of winning is its own commentary on the party's morale.)

Fortunately for the prime minister, this faith in Mr Johnson is unlikely to be tested soon. Not only do Labour Party rules make it tough to unseat a leader, but the plotting against Mr Brown is even less co-ordinated than it was during last year's failed coup attempt. Potential agitators also know that a leadership race during an economic crisis would strike many voters as unforgivably self-indulgent. The alternative, a rapid coronation of a broadly liked candidate such as Mr Johnson, could look even more unseemly, as it would be the second time in a row that the top job has been filled without a popular vote. Local and European elections due on June 4th are as much a boon as a bane for Mr Brown. Crushing losses will intensify dissent but, for the duration of the campaign, discipline should tighten in this most tribal of parties.

A story to tell

Judging by Mr Brown's unveiling of a new education policy on May 5th, he recognises that the ease with which his government is buffeted by events as frivolous as April's YouTube fiasco owes much to its lack of activity on the domestic-policy front. The announcement itself—an alleged boost to parental power over local schools—may have been piffling, and certainly not enough to satisfy those still waiting for the visionary ideas promised by Mr Brown when he entered Number 10 two years ago. But it was a start, and the spectacle of the prime minister in a classroom, rather than in the summit chambers he has occupied of late in world-saving mode, may begin to blunt the popular perception of remoteness that dogs him. More policy moves are scheduled over the summer on crime and elderly people.

There are other scraps of hope for him. By reviving the cabinet career of Lord Mandelson, an erstwhile foe but a minister and strategist of undoubted gifts, the prime minister's last reshuffle galvanised the government. Another bold change—ditching Jacqui Smith, the unloved home secretary, for example, and recalling a grizzled big-hitter such as former cabinet member John Reid—may achieve something similar.

Secondly, the Tories have foundered most when pressed to define themselves on contentious issues: selective schools and the nationalisation of a failed mortgage lender were ignominious cases in point. They may do so again as they are forced to detail their tax-and-spend plans. (Not everyone in government shares Mr Brown's certainty that the Tories remain vulnerable to the charge of planning cuts in public services, an attack perhaps more effective in the boom-time elections of 2001 and 2005 than in austerity Britain.)

Above all, salvation for Mr Brown depends on a rapid economic recovery. The government expects GDP to start growing again before the election. Unemployment is likely to continue to rise, but the return of growth may allow Mr Brown to reap the credit for stabilising the banking system and averting a worse slump. Wishful thinking, perhaps. After all, even his wiser decisions as chancellor (such as using the bounteous proceeds of a mobile-phone network auction in 2000 to pay down national debt, which can now rise more safely) are lost in the haze of recrimination. But such thoughts are not limited to bullish Labour types. One senior Tory, who predicted Mr Brown's bounce in popularity last autumn, expects another narrowing of the polls before the election.

A fourth-term Labour government remains improbable, even if all of the above transpires. And for the time being, it would be unsurprising if Mr Brown were planning weeks rather than months ahead. He is persisting with policies loathed on the Labour benches, such as bringing in national-identity cards (see article) and the part-privatisation of Royal Mail. It may have the effect, intended or not, of reviving his old image as a man of principle. This took a hit in 2007 when he ducked a snap election and appropriated the Tories' pledge to cut inheritance tax, an idea that offended his instincts but looked a vote-winner. It has since been diminished further by tax changes designed more to wrong-foot the Tories than to raise money.

But such doggedness comes at the cost of further, perhaps fatal, rebellions. Unless concessions are made to backbenchers, Mr Brown must rely on Conservative support to pass his legislation on the postal service—a fate almost as damaging as seeing the bill fail altogether. The vote could take place soon after the elections on June 4th. Humiliation for Mr Brown in both encounters with hostile opinion will surely sharpen the daggers now poised at his back.

Michael Savage excluded

The creeps of wrath

May 7th 2009
From The Economist print edition

If your name is down, you're not coming in

AP

Mr Savage mulls his suit

AS IF Jacqui Smith didn't have troubles enough at home, she has now put up the back of one of America's most splenetic radio talk-show hosts. Michael Savage says he will sue the "lunatic" home secretary for including his name on a list, published by her department, of some of those banned from entering Britain between the end of October last year and the end of March 2009. Others who feature include assorted Muslim preachers, a Jewish extremist, a Hamas activist, a homophobic Baptist pastor, a pair of Russian skinheads, a neo-Nazi and a former grand wizard of America's white-supremacist Ku Klux Klan.

Mr Savage (né Michael Alan Weiner) protests that he does not promote violence, and objects to being bracketed with those who do. His "shock jock" views are not always edifying: he has described the Koran as a "book of hate", for example, and said horrid things about autistic children. But on Ms Smith's edict, he has a point.

Free speech is meant to be one of those core values that Britons would fight to the death to defend. But the rules on just how much of it is allowed in and into the sceptred isle have been tightening.

After the London bombings in 2005—amid worries that London had become "Londonistan", a semi-inadvertent sanctuary for foreign Islamist radicals—the home secretary was given the power to refuse entry to those who promote or foment hatred, terrorist violence or serious criminal activity. In October 2008 a presumption in favour of exclusion was introduced, which means that it is up to the dubious individual to prove that he would not "stir up hatred" in Britain if he visited, and that he has publicly repudiated his "previous extremist views".

A total of 101 people were kept out between August 2005 and March 2009. (Geert Wilders, a Dutch MP with harsh views on Islam, was refused entry earlier this year under a related European rule.) The exclusions are currently running at five a month. They raise a serious objection and a theoretical question.

The objection is whether the power of exclusion is being applied equally, and indeed whether it could ever be. Some maintain, for example, that undue sensitivity has been accorded to the feelings of Muslims in deciding whom to rebuff. The rational rule would surely be that only advertised views that clearly constitute a crime in Britain should be sufficient grounds for turning away foreigners.

The question is how the history of Britain, and indeed the world, might have differed had the power to exclude been applied in the past using the current criteria. Karl Marx might not have made the cut; nor would the assorted Bolsheviks who plotted in the East End of London before their revolution. Ditto Gandhi and various members of the ANC.

ID cards are go

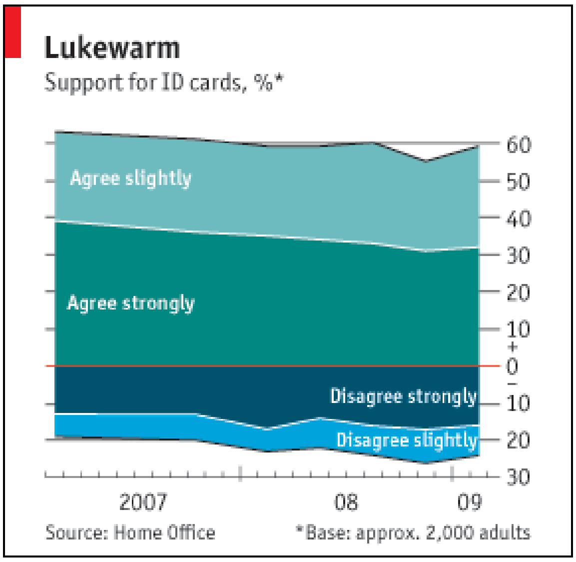
Ploughing on

May 7th 2009
From The Economist print edition

Forcing through a divisive plan is judged less damaging than dropping it

TOOTHBRUSH, soap, biometric fingerprints: shopping lists at pharmacies will soon be more exotic, now that the government has announced plans to let chemists, post offices and assorted other high-street shops process applications for its controversial new identity cards. On May 6th Jacqui Smith, the home secretary, announced that from this autumn the scheme, which until now has applied only to certain non-European folk, would be tried out in Manchester. Mancunians will be able to get an ID card for a fee of £30 ($45), plus another £30 or so to have their mugshots and fingerprints taken. It will allow them to travel passport-free in Europe and to prove their identity when buying a beer or a mortgage, and will also, the government says, help protect society from illegal immigrants, terrorists and fraudsters.

Before Ms Smith's announcement, many had thought the identity scheme was dead. Its alleged benefits always seemed modest for the £5.3 billion that the Home Office estimates it will cost over the next decade; and, as Britain's public finances plunged into the red, it was an obvious candidate for the chop. David Blunkett, a former Labour home secretary, said last month that new passports would be just as good. Alistair Darling, the chancellor, seemed to hint as much a few days later.



Now, perhaps keen to avoid another of the screeching u-turns that have been provoking mutiny within the Labour Party, the government is pressing ahead. Downing Street may reckon the cards will win votes: public support for them is strong-ish, though sliding (see chart). Ministers say little would be saved by scrapping the cards, since the next generation of passports, which will use the same fingerprint technology, accounts for two-thirds of the scheme's budget.

Both arguments are suspect. ID cards' popularity depends on how pollsters phrase their questions. Only about half the public know that there will be a charge. When polls by no2id, a pressure group, mentioned the cost, net support fell to zero. Hostility from particular groups could make things sticky: a pilots' union has already said it will challenge a forthcoming requirement that airmen carry them. And concern about civil liberties may become more than a hobby, especially given separate plans, announced on May 7th, to store for up to 12 years the DNA of anyone over ten who is arrested, even if not charged.

The costings are misleading too, in a way that flatters the scheme. The headline budget omits the scanners that hospitals, benefit agencies and others would need to read the chips inside the cards. If potential users decide to spend their money elsewhere, the cards may be checked only visually, thus rendering them no more secure than any old bit of plastic. At the moment, employers cannot buy the

scanners even if they want to; official advice suggests flicking the cards to test their authenticity, because they have a “distinctive sound”.

As for the argument that almost as much would need to be spent on new passports anyway, Edgar Whitley of the London School of Economics points out that current ones already contain enough biometric data to satisfy any country in the world, including America. The Home Office says it is better to be at the leading edge in such matters. But the suspicion remains that passports are being souped up in order to keep the fingerprint technology out of the contentious ID-card budget.

Britain's Muslims

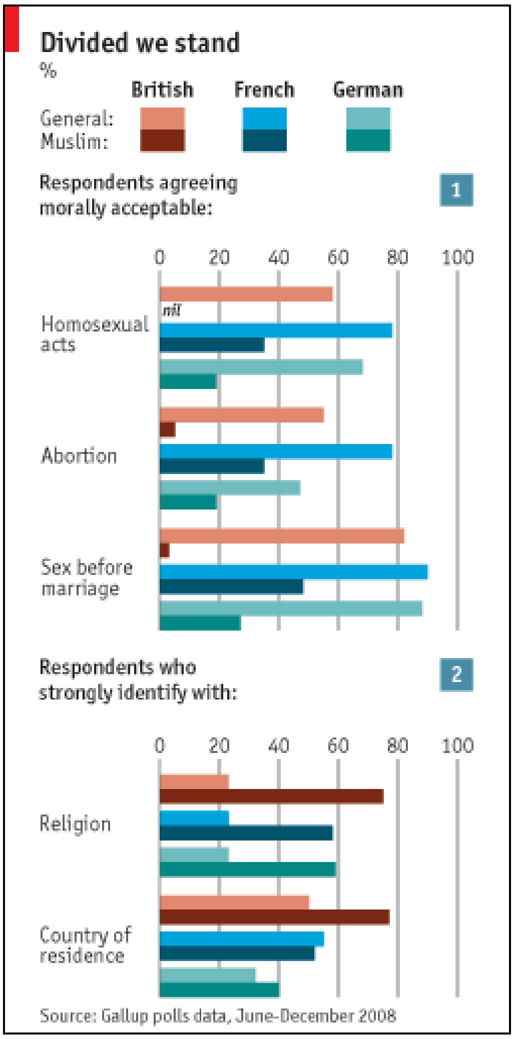
Pious, loyal and unhappy

May 7th 2009
From The Economist print edition

Less like their non-Muslim compatriots than adherents of Islam elsewhere, but British nonetheless

WHETHER strong religious identity, and the ethical views that go with it, necessarily undercut national identity has long furrowed brows, especially in Western secular democracies with heavy immigration. Terrorist attacks in London and Madrid, and racial unrest in France, have made the debate more urgent. What makes for national cohesion? A study put out on May 7th by Gallup, a polling organisation, casts new light on the matter.

Few would be amazed to learn that European Muslims are much more conservative socially than their non-Muslim compatriots. What is surprising is how wide the gap is in Britain. Gallup looked at attitudes in France, Germany and Britain on some key issues of personal morality among adherents of Islam and the public in general. The gap between Muslims and others on the acceptability of homosexuality, abortion and premarital sex was wider in Britain than in either Germany or France (see chart 1), even though British non-Muslims professed themselves more strait-laced than their continental counterparts on most issues.



But what really divides British Muslims from their co-religionists elsewhere, according to Gallup, is not so much their attitudes as their dissatisfaction with life. Using a broad measure of economic and personal well-being, only 7% of British Muslims called themselves “thriving” compared with 56% of the British public. In France a much higher proportion of Muslims were thriving, and in Germany Muslims were more apt than the general public to say they were doing well.

The unhappiness of British Muslims is easy enough to explain: their living standards tend to be low and relatively few of the women work. They are also less likely than Muslims elsewhere, Gallup found, to see learning the local language, finding a job or getting a better education as a precondition for integration. That may be because they are remarkably unambitious; but it could reflect Britain’s official tradition of encouraging cultural diversity.

Yet these differences, however marked, do not mean that British Muslims identify less with their country of residence than Muslims in France or Germany—or, indeed, than non-Muslim Britons (see chart 2). Dalia Mogahed, Gallup’s chief researcher on Muslim affairs and member of a panel that advises President Barack Obama, thinks integration in Europe will prove difficult only if non-Muslims expect adherents of Islam to share the ethical positions of the rest of European society, instead of, as now, holding views more characteristic of the American Bible Belt.

Scotland's Muslims

Islam in tartan

May 7th 2009 | GLASGOW
From The Economist print edition

Changing identity and nationalism north of the border

Reuters

MUSLIMS in Scotland have historically given their allegiance to the Labour Party, long seen as the champion of the underdog. That may now be changing. Last month the Scottish National Party (SNP) picked a Muslim activist to fight the Westminster constituency of Glasgow Central. Osama Saeed, a former spokesman for the Muslim Association of Britain, which is ideologically close to the Islamist Muslim Brotherhood, is not everyone's cup of tea. But his selection says much about Scottish Muslims' evolving identity.

Muslims in England tend to abhor nationalism, associating it with the British National Party (BNP) and its white-supremacist nonsense. Not so in Scotland, where the BNP has failed to win a foothold. The SNP favours immigration and has crossed swords with the Home Office over better treatment of asylum-seekers.

But the attractions of the SNP for Muslims go much deeper than this. Only 5% of non-white people in England describe themselves as English (many more go for British). But 42% of non-whites in Scotland, most of them Muslim, are happy to declare themselves Scottish. Partly, that is because Scottish nationalism is not ethnic but civic, and bound up with institutions such as Scotland's distinctive school system. And although Glasgow's Muslims suffer plenty of racist slurs and attacks, these seem to be milder than south of the border. A study by academics at Glasgow University found that 49% of white Scots showed some degree of Islamophobia (fears about national identity or economic resentment), compared with 63% of English whites.

Another reason, says Peter Hopkins, a geographer at Newcastle University, is that Scotland's cultural iconography is much more vivid and more popular than England's. The demotic poetry of Robert Burns or the skirl of bagpipes at Highland gatherings are easily appreciated by immigrants. Warm beer and cricket on the green, cited by a former prime minister, John Major, as the essence of Englishness, do not much move England's white population, never mind its Muslims, he says.

It is a short, sympathetic step from identifying with Scottishness to accepting the SNP's central tenet: that Scots are a disregarded minority within Britain (contrary to evidence that they are over-represented in positions of power, from the prime minister on down), who really ought to put that right by claiming independence.

Mr Saeed says that first-generation immigrants, many of whom come from Kashmir or whose parents lived through Pakistan's struggle for independence, easily relate to the SNP's cause. His conversion came at a lecture by Alex Salmond, the SNP leader and Scotland's first minister, which, he says, "blew away the myths that Scotland was too small and poor to be independent". Mr Salmond has toiled to convince Scottish Muslims that the SNP is on their side. It seems to have paid off—in 2003 after the Iraq war (vehemently opposed by the SNP), they were twice as likely to vote Nationalist as were white Scots.

All the same, Mr Saeed—selected, says an SNP spokesman, not just because he was Muslim but also because he was one of a generation of bright, young pro-independence Scots—has a tough task ahead. The sitting Labour MP for Glasgow Central, Mohammad Sarwar, was the first British Muslim to be sent to Westminster, in 1997. In 2005 he won 48% of the vote, well ahead of his rivals, while the SNP came third with 15%. (Muslims make up almost a tenth of all voters in the constituency.)

But Mr Sarwar does not plan to stand again; he received death threats after helping police to find the

Pakistani perpetrators of a particularly ugly murder of a white youth in 2004. Labour has chosen his son Anas, a dentist, to take his place. Given current outrage at MPs feathering family nests with taxpayers' funds, voters may not take kindly to such dynastic succession.

Protecting children

When parents don't

May 7th 2009
From The Economist print edition

Trying to make sure social workers are up to their thankless job

THE case of Baby P, a toddler tortured and killed by his supposed carers, shocked Britain after the conviction last year of his mother, her lover and a lodger. The grim tale now turns out to have a horrible coda. On May 1st verdicts were returned in the trial of the mother and her boyfriend for the rape of a two-year-old. The mother was acquitted of cruelty—the victim told police she had seen the rape, and failed to intervene. The boyfriend was convicted and may get a life sentence.

The case made legal history. The child, aged three at the time of the trial and cross-examined via video link, was the youngest ever to give evidence in a British court. Also unusual was the decision to use false names for the defendants, and to ban all reporting until after the verdict. The fear was that the defendants would not be tried fairly if the jury made the connection with Baby P—or Peter, as he can now be called after his father asked for him to be dignified with his name.

In reaction to public outrage at the failure of social services to protect Baby Peter, Ed Balls, the secretary of state for children, schools and families, commissioned a review of child protection from Lord Laming, who had done a similar job after the murder in 2000 of Victoria Climbié by her guardians. On May 6th Mr Balls published his response to Lord Laming's findings.

Among the mostly sensible proposals were some intended to mitigate the consequences of that earlier review. It had concluded that failures of communication had been the main problem: Victoria had been seen by many professionals, including doctors and social workers, none of whom had realised that she was already an object of concern. But the electronic form Lord Laming's first review spawned, which must be filled in whenever a child is referred to social services, has turned out to be an obstacle, not an aid. The form, and the database on which cases are logged, are now to be trimmed. And directors of the sprawling new children's-services departments created for all those professionals intended to work together must, if they are inexperienced in child-protection work, find a deputy who knows all about it. (Most directors are ex-teachers.)

But for all the talk of cross-agency communication, the most egregious recent failings in child protection have been by social workers. Peter and Victoria were both on the "at risk" register and seen regularly. Separately, social services in Doncaster are being investigated after seven children on their register died in the space of three years. And on May 6th a leaked report from the UK Border Agency suggested that 77 children who had arrived unaccompanied from China had gone missing from a single care home since 2006. They are thought to be have been victims of child trafficking. Only four have been found, two working as prostitutes.

A revamp of social-work degree courses, more on-the-job training and an advertising campaign to lure qualified social workers back to the front-line: none of Mr Balls's plans is bad. But they will hardly resuscitate a profession in crisis. Each failing leads to further vilification: the *Sun*, a tabloid newspaper, campaigned to get everyone who had ever interacted with Baby Peter sacked. Nationally, 13% of child-protection posts are vacant; in Haringey, where both Victoria and Peter died, the figure is 35%. Average pay for social workers is £28,000 a year; for teachers, it is £34,000—and Mr Balls confirmed there are no plans to close the gap. A survey by Unison, a public-sector union, in January found that two-thirds of social workers were looking for other jobs.

State aid for industry

Thin end of the wedge

May 7th 2009
From The Economist print edition

Government schemes aplenty, but some companies still go a-begging

AT LAST there is some evidence that state support is getting finance to struggling businesses. Mr Ben's Supplies, a pet-food merchant near Swindon, has managed to borrow £85,000 from Barclays Bank under the government's Enterprise Finance Guarantee (EFG) scheme. Announced in January, this offers a state guarantee for 75% of a qualifying small-business bank loan; if Mr Ben's goes bust, the taxpayer pays up and Barclays gets at least three-quarters of its money back.

Gordon Heywood, who owns Mr Ben's, is delighted with his loan: "I wouldn't have got it without the guarantee, which costs under £1,700 a year," he says. He was less impressed with the antics of other banks he approached, including his house bank, HSBC, and the largely state-owned Royal Bank of Scotland. Having promised much larger sums, they ran around for months "like headless chickens" before turning him down.

The Department for Business, Enterprise and Regulatory Reform (BERR) trumpets Mr Ben's case on its website as an example of the EFG at work. So far £170m has been lent under the scheme to almost 2,000 businesses, with applications for another £155m in the pipeline. It is just one of several measures announced over the past few months to straddle the gap between banks, bruised by their own excesses, and the real economy they are currently unable, or unwilling, to support.

The government has recapitalised two big banks, exacting lending commitments in return. In January it said it would give 50% guarantees for up to £20 billion of bank loans to businesses with turnover of less than £500m; so far £1 billion-worth of loans has been covered. The European Investment Bank last month agreed to give two carmakers, Jaguar Land Rover (JLR) and Nissan, loans of £340m and £180m respectively for low-carbon car projects, subject to a Treasury guarantee. The terms of the JLR rescue, and of a further guaranteed bank loan of £450m, were still being haggled over as *The Economist* went to press.

At the regional level, £21.6m of a £25m pot of "transition funds" has been lent to around 200 companies. Meanwhile the government is investing in small firms through a £75m public-private Capital for Enterprise fund: proposals total £60m to date. Another shove was given in the budget last month. Credit insurance will be topped up for companies whose cover was slashed by their insurers, and the state will match a £1,000 handout from car dealers to those scrapping old cars for new.

Efforts to reduce funding costs for big companies, though, are not yet biting. The Bank of England's Asset Purchase Facility, designed to buy corporate and government debt, has mopped up only £522m of corporate bonds and £2.1 billion of short-term commercial paper. Corporate-bond yields have fallen only slightly.

The measures have got some money flowing, says the Federation of Small Businesses. But none of them, it seems, fitted the case of LDV, a van-maker in Birmingham with 850 employees. It has had a chequered history since its parent, Leyland DAF, went bankrupt in 1993, passing through two private-equity firms before landing with GAZ, a Russian automotive group. GAZ stopped LDV production in December. Efforts to find a new owner almost ended in failure. But on May 5th BERR stepped in with a one-month £5m bridging loan in the hope that Weststar, LDV's Malaysian distributor, might buy the firm.

The first sign of a new industrial policy and an admission that, even with all that government help, banks are not doing their job? The answer is more complicated. Potential lenders were deterred by the fact that GAZ is strapped for cash. Negotiations were hampered by press reports of "scandalous" meetings between its owner, Oleg Deripaska, and British politicians in Corfu. Finally it became clear, says Guy Jones, marketing director of LDV, that the likely cost to the taxpayer of a bankruptcy—still a possibility—outweighed risking £5m of taxpayers' money. As more jobs are threatened and an election looms, that argument may be rehearsed again, many times.

Bagehot

There is no alternative

May 7th 2009
From The Economist print edition

The permanence of Thatcherism and the politics of unpopularity

Illustration by Steve O'Brien

POLITICS has turned funereal. New Labour was buried by ululating commentators after last month's flawed budget. Now the -ism that spawned Tony Blair's hybrid creed is apparently following it into oblivion. The 30th anniversary of the Iron Lady's first general-election win in May 1979 has been marked by reports, often exultant, of the death of Thatcherism.

There are two strands to this diagnosis. One is that Margaret Thatcher's deregulatory reforms, in particular the "Big Bang" of 1986, caused the financial crash; in this critique Mrs Thatcher (as she was in office) personally dispensed bankers' bonuses from her handbag. The wider point is that the economic model she advocated, and which her apostate Labour successors embraced, has been discredited. Neo-liberal, Thatcherite economics, runs this argument, was fatally undermined by its own internal weaknesses, then interred after the crunch amid a mêlée of Keynesian splurges and nationalisations. None of us is a Thatcherite now.

The first charge is true only in the way that, say, the Versailles treaty "caused" the second world war. There have been too many intervening years, factors and governments for the case to stand up—though it reflects Mrs Thatcher's mythic status that, for some, she *must* be to blame. The wider argument is plain wrong. The themes of British politics in the next few years will be recognisably Thatcherite. So will many of the policies.

Conviction and confusion

One nostalgic motif may be confrontation with trade unions. Of course, they are not the destructive power in the land that they were in 1979: Mrs Thatcher saw to that. Their membership has shrunk; their leaders are saner. All the same, the squeeze on pay and pensions in the public sector that may be needed to help cut Britain's deficit will doubtless provoke a serious punch-up.

Another is privatisation. Admittedly, the state has temporarily taken charge of the new commanding heights of the economy, the banks. But elsewhere the process of privatisation begun by Mrs Thatcher and furthered by her heirs continues: witness the row between Gordon Brown and Labour MPs over plans for

Royal Mail. More importantly, in areas that Mrs Thatcher only nibbled at—health, education and welfare services—politicians will push on with bringing in private provision and applying the rigours of the market to the functions of the state.

Then there is the question of tax. The new top rate of income tax, of 50% for earnings over £150,000 ($225,000), is cited as evidence of Thatcherism's combustion. Yet the angry response has shown how widespread and ingrained is the doctrine that Mrs Thatcher preached: that low tax is good for both enterprise and government revenues. Moreover, while the latest increase may be myopic, it is scarcely the sort of confiscatory levy imposed before she took over: the realm of the possible in taxation has shrunk. Taxes may rise in the immediate future (as they did after the notorious budget of 1981); but a 1980s-style backlash against over-taxation across the whole spectrum of wealth may well follow. There could be a renewed push for tax reform, shifting the burden, as Mrs Thatcher did, from income tax to other kinds.

Britain is not the place it was in 1979: it is more complex, more tolerant and hedonistic, haunted less by imperial decline than by pseudo-imperial overstretch. Its problems are different too. Thirty years ago, taming inflation and making the country governable were Mrs Thatcher's first priorities. Now one pressing need is to fulfil an aspiration she never realised: a dramatic reduction in the proportion of national wealth consumed by the state. For all the excitable short-term neo-Keynesianism, the basic long-term solution is Thatcherite: stringent economic discipline.

Imposing that discipline will bring with it two other Thatcher trademarks: controversy and intermittent unpopularity. The atmosphere of politics, like some of its content, is set to be Thatcherite. And Mrs Thatcher's experience offers her successors a template for the uses and management of opprobrium.

For Mr Brown, the comparison is shaming. Shortly after he moved into Number 10, he invited Mrs Thatcher round for tea, describing them both as "conviction politicians". Yet whereas her premiership was controversial in pursuit of a transformative goal, his has been a study in purposeless unpopularity.

Meanwhile David Cameron, the current Conservative leader, is in one sense the first post-Thatcherite holder of that office; only now have the clefts in the party left by her ousting healed. Mr Cameron is a different sort of Tory: less of an economic determinist than Mrs Thatcher, more socially liberal, more in the party's "one nation" tradition. But he has assimilated at least one major lesson of her often misremembered career. She was a revolutionary but also an incrementalist, whose biggest upheavals were mostly not announced in her manifestos.

Mr Cameron is being similarly cautious. He now lauds Mrs Thatcher where once he seemed to distance himself from her, using her name as a byword for political bravery—but without saying precisely what form his own bravery will take. His Tory colleagues talk about how loathed they expect to be after six months in government—but not exactly why. The outstanding question is this: for all the shortage of upfront details, Mrs Thatcher knew what she wanted to achieve. Do the Cameroons?

At a recent press conference Mr Cameron was asked about the Thatcher anniversary. Serendipitously, as he answered, a military band struck up outside the window; Mr Cameron clenched his fist and talked with mock bombast about giving "pride back to Britain". He is of a generation for whom invisible, ironising inverted commas hang above any grand or portentous statement. They didn't for Mrs Thatcher. Her lesson is that Mr Cameron needs to know his mission, stick to it and hold his nerve.

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Emerging markets and the credit crunch

Whom can we rely on?

May 7th 2009
From The Economist print edition

Poor countries are not fretting about the boundaries between state and market. Instead, they are debating whether to rely on domestic or foreign demand

Illustration by Claudio Munoz

A STRIKING feature of the worldwide economic crash is what hasn't happened. While rich countries agonise about whether Anglo-Saxon capitalism should be replaced by the French version (and the French flirt with revolutionary socialism), emerging markets have stayed angst-free. Arvind Subramanian, an Indian economist, says there has been "no serious questioning of the role of the market."

That may sound like an exaggeration. As in rich countries, the state's role in many poor ones has increased as a result of the recent global meltdown. China's 4 trillion yuan ($587 billion) stimulus package last year will benefit state-owned enterprises. Its sovereign-wealth funds have been buying stakes in publicly-traded companies and (as in America and Europe) state subsidies have been flowing to loss-making industries, such as carmakers.

In India, critics of liberalisation have gained ammunition. They have long cautioned against giving foreign banks freer rein or allowing pension funds to invest more money in stockmarkets, leading one prominent magazine to ask, "did the left save India?" Some economists called the central bank timid last year for resisting attempts to let international capital flows dictate the value of the rupee. It now feels vindicated. Depositors have also been shifting away from private banks—former stars of the new Indian economy—towards once-unfashionable state-owned ones. While private banks retrench, state ones are expanding their lending vigorously.

Yet such state intervention is driven not by ideology but, mostly, by pragmatism. In China the Adam Smith-toting prime minister, Wen Jiabao, argues that his country "would rather speed up reforms" to combat the crisis and should "give full play to market forces in allocating resources". Whereas American and European countries have re-regulated business, China, set on meeting its 8% growth target, has continued to liberalise. This year, for example, it removed some barriers that curbed the yuan's use in international trade.

Few if any serious attempts have been made to restore state ownership. When Embraer, a formerly

state-owned aircraft manufacturer in Brazil, laid off thousands of workers, unions demanded its renationalisation—in vain.

In other words, emerging markets have adopted different policies, as well as ignoring the rich world's philosophical agonising. But why?

The first reason is that the global crisis originated in America and Europe and inflicted itself on the rest of the world. So emerging-market governments see little reason for painful self-examination in response to other people's problems. Moreover, the largest emerging markets are beginning to see hints of recovery. China's output was 6% higher in the first quarter of this year than it had been in the same period in 2008. Chinese and Indian manufacturing output rose in April, pushing Asian stockmarkets up sharply. Though these are merely short-term gains, they are enough to deflect navel-gazing for the moment.

Second, in many emerging markets, the state is fairly large already, especially in banking. The current demarcation between state and market commands broad public support and the main issue, as Mr Subramanian puts it, "is how to continue reducing [the state's] role in a gradual and pragmatic manner." So even if the demarcation line shifts statewards in rich countries, emerging markets are well beyond that point already, and see little advantage in moving the line any farther.

Tricks of the trades

Yet the global crisis has provoked anguished disagreement about an equally fundamental matter: how much to rely on exports and how much on domestic demand. At this month's annual meeting of the Asian Development Bank, minister after minister said countries should rely more on each other and less on selling to America. Thirteen Asian countries also agreed to create a $120 billion fund—part of a nine-year-old system of swap agreements called the Chiang Mai initiative—from which they can (in theory) draw when financial pressures become acute.

How this would work in practice is uncertain. But the impetus behind it is clear: pooling risk expresses Asian fellow feeling and common Asian caution about both the International Monetary Fund and further fallout from America's crisis. Emerging countries concluded from the financial crises of the 1990s that they could not rely on fickle foreign capital. Now the collapse of international trade is causing them to wonder whether they can rely on fickle foreign customers.

Piracy

Wrong signals

May 7th 2009
From The Economist print edition

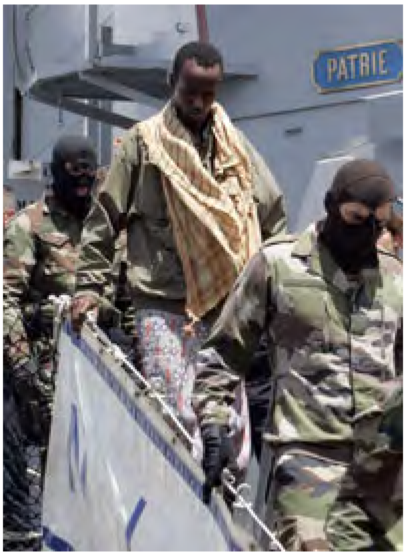
Confusing laws hamper international naval efforts to fight piracy

WHEN pirates attacked the *MV Kition*, a Greek tanker, late at night in the Gulf of Aden on May 1st, a Portuguese helicopter scared off the assailants and tracked their skiff to its "mother ship". Portuguese special forces boarded the vessel and found dynamite, automatic rifles and rocket-propelled grenades (RPGs). That was plenty of evidence, but the pirates went free (after being disarmed). Other countries, including Canada and the Netherlands, have acted similarly. America says such leniency sends "the wrong signal".

Elsewhere in the lawless waters off Somalia, European navies have been more robust. French commandos have used lethal force to free hostages. Other navies have arrested dozens of suspected pirates and sent them for trial in nearby countries. On April 26th, a Spanish warship helped the Seychelles authorities detain nine Somalis linked to an attack on an Italian cruise liner, the *MSC Melody*, a day earlier. Sailors and security guards had fought them off; a passenger who saw them coming hurled a deckchair down at them.

The difference in outcomes is odd. The requirement to fight piracy is one of the oldest bits of international law. The idea that any country may take action against pirates is the precursor to the idea of "universal jurisdiction" used to prosecute heinous crimes such as genocide. In Latin legalese, pirates are termed *hostis humani generis* (an "enemy of mankind"). Moreover, the UN's Convention on the Law of the Sea stretches the definition to include crewing a pirate ship and inciting or "intentionally facilitating" attacks. Surely sailing with RPGs, long ladders and grappling hooks should fall within this definition?

Reuters



Gotcha! But what next?

But many countries have not fully incorporated all this into their national legislation. Some make arrests only if their own nationals or ships are attacked; the Portuguese navy said this was why it released the pirates who attacked the *Kition*. Britain's Royal Navy usually requires clear evidence of an actual attack. Just owning piratical kit may not be enough. It is not illegal to bear arms on the high seas.

Coalition politics are also awkward. Navies taking part in the European Union's Operation Atalanta have an agreement to hand over captured pirates to Kenya. But NATO doesn't. So vessels under the alliance's command (except British and American ones) can only "protect and deter".

Practical considerations count too. Naval cover is stretched thinly over a vast tract of ocean, so delivering suspects to Kenya, say, would take a valuable warship off patrol. Worse, cumbersome court procedures there tie up sailors onshore. Faced with that, some officers reckon it is better to chuck captured weapons overboard but let the people go.

A new international court for pirates, as proposed by Russia, is one idea, but would take a lot of time and money. Douglas Guilfoyle, a law don at University College London, says efforts would be best aimed at boosting the legal systems of Kenya and other countries. The real answer is to sort out Somalia. And navies can't do that.

Philanthropy

Give and count the cost

May 7th 2009 | WASHINGTON, DC
From The Economist print edition

Rich donors are hit by the credit crunch. Bad news for the poor

NO SOONER had philanthropy become fashionable than the credit crunch shrivelled fortunes and the donations they sustain. In the decade to 2007 America's charitable foundations' assets had doubled to $682 billion, according to a study by the Foundation Centre, a charity-research outfit in New York. But by the end of last year they had shrunk by just over a fifth, to $530 billion. Two-thirds of the foundations expect to cut giving this year, probably by around a tenth overall.

Poor countries were already coping with higher prices for food and fuel, putting 130m-155m people below the poverty line, the World Bank reckons. The financial crash has hit another 50m. So some people who used to have three meals a day, for example, are eating only two. The downturn has curbed tax-financed help too. Even after the grandiose promises made at aidfests such as the Gleneagles conference in 2005, rich-country aid to poor countries actually fell by 8.5% in real terms from 2006 to 2007. Now it will shrink further.

The biggest flow of money from rich countries to poor ones is remittances. They may cushion poverty for some but do not deal with bigger problems such as, say, public health. The World Bank says remittances too will shrink, by between 5% and 8% this year.

Governments hope that charities can fill the gap. The Bush administration liked the idea in theory and had some big, if piecemeal, successes. Now the talk is of a grander design, with the Obama administration hoping to put development aid on a par with defence and diplomacy. Hillary Clinton highlighted the new reliance on charities, telling donors last month that the State Department's doors were "wide open—we just need you to walk through."

The big donors' wallets are still quite bulgy: a study by the Hudson Institute, a think-tank, notes that they plan their giving years in advance. Some of the biggest foundations base their grant-giving on a three-year average of their assets. All that helps to smooth market wobbles. The vast majority of American foundations say that they will keep up the same spending pattern. Some may go so far as to dip into their endowments to keep spending levels steady or use them to make loans to charities on the ground.

The word at a do-gooders' shindig held in April, the Global Philanthropy Forum, was that big private donors will want cannier use of their money. One change would be to tie donations more tightly to specific projects. Another would be to concentrate on collaboration with existing projects rather than starting prestigious new ones. The outfits that receive the money to carry out the good works see it a bit differently. They want more flexibility, not tighter rules.

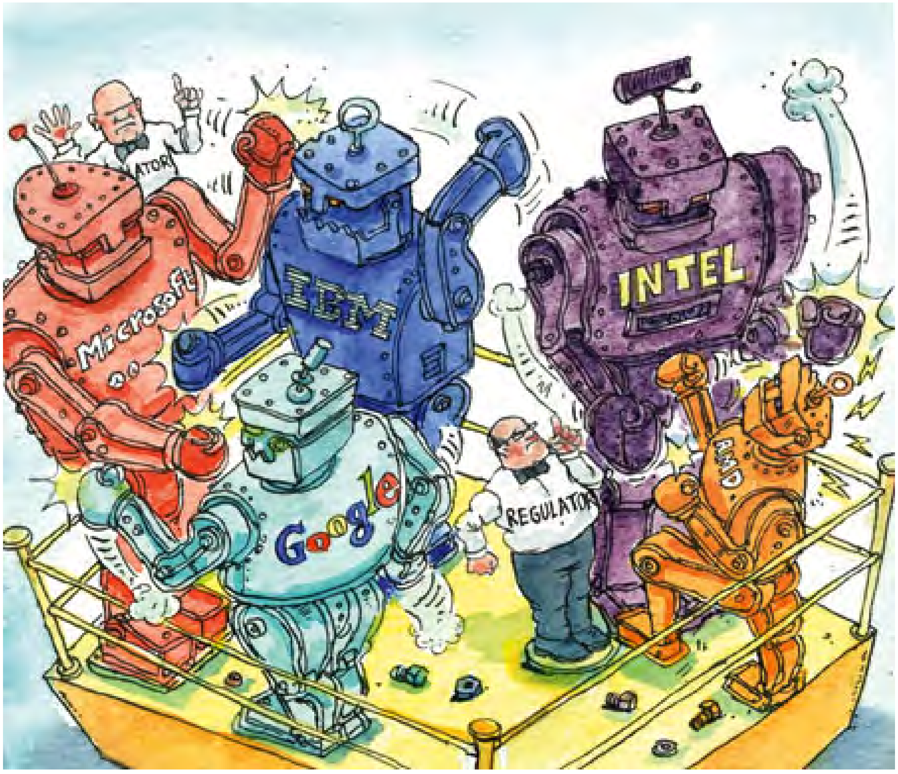
But both sides question the idea that private giving can make up for stingy state spending. Compared with the nearly $104 billion that rich-country taxpayers provided to poor countries in 2007, American foundations, by far the richest, sent only $5.4 billion overseas.

Here we go again

May 7th 2009
From The Economist print edition

Will the computer industry ever escape its antitrust problems?

Illustration by David Simonds



"THIS antitrust thing will blow over." Thus Bill Gates, then the boss of Microsoft, a decade ago as regulators launched an action against his company. The chiefs at other big technology firms, even if they were not quite so outspoken, doubtless held similar views when their companies were targeted by trustbusters. It was wishful thinking then, and remains so today, as long-running antitrust actions flare up again and regulators ponder new moves against the industry's giants.

Perhaps as soon as next week the European Commission will issue its long-awaited decision in the case against Intel, the world's biggest chipmaker. It is expected to impose a whopping fine of at least €1 billion ($1.3 billion). In early June Microsoft will defend itself in a hearing in Brussels against accusations that it illegally bundled its web browser with its Windows operating system—the very practice that got the software company into trouble in the late 1990s. IBM, the target of trustbusters since the 1950s, faces a new antitrust complaint. And Google, the industry's newest giant, is also coming under closer scrutiny. On April 29th it emerged that America's Justice Department is examining whether Google's settlement with authors and publishers over its book-search service violates antitrust laws; and on May 5th the Federal Trade Commission (FTC) launched a probe to see whether Google's sharing of two board members with Apple reduces competition between the two firms.

The computer industry makes more antitrust headlines than others, and seems unlikely to shake off these problems, for three reasons. The first is that technology heavyweights are often dominant in their respective markets. Ask any of the bosses of these firms why they are so dominant and they will probably respond that it is a result of billions spent on research and development. But they also operate in markets that allow a winner to take all (or most). Mainframes and operating systems benefit from strong network effects: the more applications run on them, for instance, the more users they attract, which encourages programmers to write more applications for them. With microprocessors, ever-increasing capital requirements mean only the biggest firms can afford to build their own factories. The markets for search

and online advertising exhibit similar effects: the bigger a firm's market share, the greater its ability to attract advertisers, thus bringing in the money to build ever bigger data centres. In each case it is difficult for an upstart to break in.

But it is not impossible. A second characteristic of the industry is that dominant positions can be undermined by technological progress: mainframes, for example, were dethroned in the 1980s by smaller machines. Because they cannot afford to rest on their laurels, high-tech heavyweights often foster aggressive corporate cultures that draw the attention of antitrust regulators. It is no accident that Andy Grove, a former boss of Intel, entitled one of his books "Only the Paranoid Survive".

Aware of the risk that the spirit of competition could become abusive, Intel has long made sure that its employees undergo compliance training. But this did not keep the firm from crossing the line, at least in the opinion of the European Commission. It alleges that Intel, using a system of discounts and rebates, encouraged computer-makers and retailers to sell only a limited number of machines powered by chips made by AMD, Intel's only remaining serious rival in microprocessors for PCs. In one case Intel is said to have paid a retailer to forgo AMD chips altogether.

Fear of being supplanted was also behind Microsoft's decision in the late 1990s to bundle its web browser, Internet Explorer, into Windows. The European Commission's current investigation looks forwards rather than backwards, however, with the aim of ensuring that there is competition in the future. As more and more computing moves online (into the "cloud"), the browser is replacing the operating system as the central computing platform.

Thirdly, problems with antitrust will continue to dog the industry for the simple reason that companies are increasingly using it as a competitive weapon, alongside other instruments such as patent lawsuits and battles over standards. As it lost market share to Intel, for example, AMD launched a global campaign to get regulators to examine its rival's behaviour. It went to the European Commission and to its regulatory counterparts in South Korea and Japan, both of which have ruled against Intel. In America AMD has filed a private antitrust lawsuit which is due to go to trial next February. The FTC opened an antitrust investigation of Intel last June.

Similarly, antitrust lobbying is part of a broader "platform war" for IBM, which hopes thereby to keep Microsoft at bay. Among other things, IBM is a sponsor of the European Committee for Interoperable Systems (ECIS), which has many of Microsoft's other competitors as its members and is one of the prime movers behind the new browser case. It started in late 2007 with a complaint by Opera, a Norwegian browser-maker and ECIS member.

Not to be outdone, Microsoft has entered the antitrust game, too. It recently made an investment in T3, a small vendor of mainframe-like computers, which in January lodged a complaint with the European Commission, alleging that IBM kept it from competing by refusing to license mainframe software to T3's customers. Microsoft has also lobbied American antitrust regulators to tackle Google, encouraging them to look into an online-advertising deal between the search giant and its rival, Yahoo!, which was eventually abandoned.

That is not to say that the antitrust cases that are now under way are without merit, and have merely been stirred up by rival firms. But it means that regulators must make a "sound judgment" and consider whether the aggressive behaviour of industry giants actually hurts consumers, and not just rivals, argues Steven Salop, a professor at Georgetown University Law Center in Washington, DC. Ill-conceived remedies can make things worse, says Lars-Hendrik Röller, president of the European School of Management and Technology in Berlin and a former senior economist at the European Commission.

The commission's case against Microsoft looks the most robust. In September 2007 the European Court of First Instance ruled that the firm had stifled competition by tying its media player to Windows. The same reasoning should also apply to browsers, even though the browser market has become somewhat more competitive in recent years, thanks to the rise of Firefox, an open-source browser. The commission will probably ask Microsoft to include the most popular rival browsers with Windows, asking users to choose one when they boot up for the first time.

The case against Intel is trickier. Offering discounts and rebates is common in many industries, so the case hinges on whether Intel attached conditions to such rebates that constituted an abuse of its market position. It is unclear whether any harm has been done: prices for chips continue to fall, innovation has not slowed down and AMD has increased its market share slightly in recent months. And certain remedies could actually limit competition. Limiting discounts, for instance, might in effect create a price floor for AMD, given that it is Intel's only competitor.

IBM, for its part, would appear to have little to fear. It is hard to argue, with so many different computer systems around, that mainframes still constitute a separate market—a necessary condition if IBM's behaviour is to be judged anticompetitive.

That leaves Google. If history is any guide, it can expect a run-in with trustbusters before long. But the firm is aware of this, and has trodden carefully as a result. The crunch is likely to come when a serious competitor emerges in search or advertising—Google, after all, toppled AltaVista, the previous leader in web search. For the industry as a whole, meanwhile, it seems unlikely that the antitrust thing will blow over any time soon.

Economist.com BUSINESS

Mergers and acquisitions

Buying on the dips

May 7th 2009
From The Economist print edition

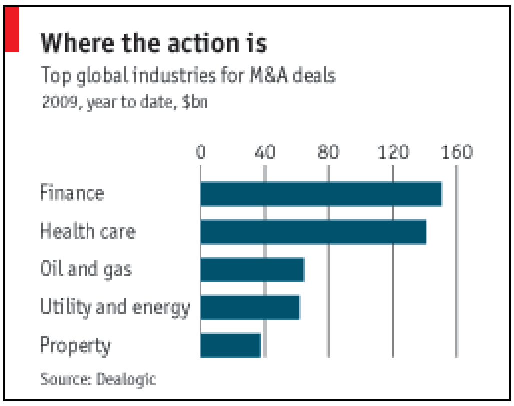
What sorts of deals are still being done in today's difficult climate?

TO GET a takeover right is extraordinarily hard. The majority of deals fail: managers overpay, overestimate the savings deals will generate and often clobber their firms' balance-sheets by trying to make a great leap forward. So what to make of the deals that have taken place so far this year, against the worst economic backdrop for a generation? The surprise is that there is any activity at all. Deal volumes are down but not out. They have stabilised since the nadir of the fourth quarter of 2008 and the run rate is about 80% of the average over the past decade, according to Dealogic, a financial-analysis firm.

About a third of the volume of big deals relates to restructuring banks. Much of the remainder is composed of what might be called "housekeeping" in which two firms rejig an existing relationship, usually with the dominant partner taking full control. This accounts for five of the ten biggest deals. Enel, an Italian utility, is buying out minority shareholders in Spain's Endesa, for example, and PepsiCo has bid for full control of its two biggest bottling affiliates.

In uncertain economic times these sorts of deals make particularly good sense, for several reasons. The buyer knows the target well, minimising the risk of nasty surprises; most share prices have fallen; and in a bear market minority shareholders may be keener for an exit.

But what happened to the glory days of investment banking, when bosses could be persuaded to sign off on a huge deal just by being shown the new logo, and their new position above their peers in the industry league table? In fact, "strategic" mergers and acquisitions are not dead. This year the pharmaceutical mega-deal has made a long-awaited return, with Pfizer bidding for Wyeth and Merck for Schering-Plough. Two oil companies, Suncor and Petro-Canada, combined to create Canada's second-largest firm by market value. RWE, a Germany utility, swooped on Holland's Essent. And in technology Oracle, a software giant, is buying Sun Microsystems, a troubled computer-maker.



These deals share two characteristics. First, they make broad industrial sense—something of a novelty after three years of intense, and largely disastrous, financial engineering. An easy way to measure this is by the cost and capital-expenditure savings they are expected to create. For the five strategic deals listed above, these amount to annual savings before tax of $8.5 billion, which compares well with the targets' combined existing annual profits of about $10 billion. Such synergy estimates are almost always too optimistic, but that leaves a huge margin for error, particularly as the earnings multiples being paid look fairly modest—except in the case of Sun.

The second characteristic is the importance of balance-sheet strength. Several companies undertook deals that made strategic sense during the bubble, but were lured into taking on too much debt. Last year's purchase by InBev, a Belgian brewer, of Anheuser Busch, an American rival, is expected to yield over $2.2 billion of annual cost savings, for example, but lumbered InBev with over $50 billion of net debt. (This week it agreed to sell a South Korean brewery to pay down debt.) For the strategic deals so far in 2009, about a third of the consideration has been paid in shares and, more importantly, the buyers have strong balance-sheets: indeed, three of the five buyers have no significant net debt at all.

Low share prices, despite the recent rally, should mean more deals. The boss of ABB, a big Swiss industrial concern with cash burning a hole in its pocket, spoke for many executives when he recently talked of opportunities "we may never see again in our lifetimes". But in a much tougher financial climate, transactions will have to pass those two tests: they must generate big cost savings and they must leave

the combined firm with low gearing. That suggests it is worth watching those industries that have little debt—energy and technology in particular. Perhaps not coincidentally, these two industries last had a really big bout of consolidation in the late 1990s. After a decade of digestion it may be time for them to return to the table.

Peer-to-peer lending in China

Chinese borrowing

May 7th 2009 | SHANGHAI
From The Economist print edition

An internet start-up applies local twists to an existing model

DOTCOMS in China have long been known for shamelessly stealing the business models—and sometimes the visual appearance—of popular American websites and simply recreating them in Chinese (known as the “copy to China” model). This approach has spawned copies of Facebook, YouTube, eBay and other well-known sites. But many Chinese sites do more than just copy, tweaking existing models to adapt them to local customs or values.

Consider Qifang, for example, a website that provides student loans by connecting borrowers and lenders. Such “peer to peer” (P2P) lending was pioneered in other markets, notably Britain and America, though its growth has been hampered by higher-than-expected default rates (blamed on the financial crisis) and regulatory uncertainty. Zopa, a British P2P lending site, pulled out of America last year, and Prosper.com, the leading American site, had to suspend its activities while it registered with the Securities and Exchange Commission, but has just relaunched.

Qifang takes this formula and adds a couple of twists. It is focused on student loans, for which there is particular demand in China, where the authorities are keen to encourage people to go to universities and colleges. In China such loans are usually provided by community group-lending schemes, so Qifang is, in a sense, merely an online version of an existing practice. As with other P2P lending sites, borrowers are required to provide personal information about themselves to reassure lenders. In Qifang’s case, borrowers also provide family details, which increases the social pressure not to default, since that would cause the family to lose face. Money is paid directly to educational establishments, further reducing risk for lenders.

In the six months since its launch Qifang has arranged 2,500 loans worth an average of $400 each, with terms of between one and three years. Qifang offers lenders an interest rate of 5-15%, depending on the perceived trustworthiness of the borrower. There have been no defaults so far, says the company’s founder, Calvin Chin. The company also plans to raise money from charitable foundations to lend out, with the interest being reinvested to fund further loans.

There are many other examples of Chinese dotcoms that have added new features to models borrowed from abroad. Chinese social-networking sites, for example, commonly make money by selling applications, games and other add-ons to users and adding virtual currencies and payment systems. In other words, they actually have plausible business models—which is more than can be said for some of the Western sites from which they took their inspiration.

New Kindle

Big is beautiful

May 7th 2009
From The Economist print edition

Bloomberg News

Less than three months after unveiling a slimmer, sleeker version of the Kindle, Amazon unveiled a third model of its electronic book reader on May 6th. The Kindle DX has a much larger screen than the standard Kindle and more storage capacity. Jeff Bezos, Amazon's boss, announced partnerships with five universities to evaluate the academic use of the device, and with three newspapers which will provide Kindles at a reduced price to subscribers. The new Kindle will cost $489 when it goes on sale in the summer.

Chinese investment in Taiwan

Strait deals

May 7th 2009 | HONG KONG
From The Economist print edition

Acrimony between China and Taiwan gives way to business deals

TWO years ago a Chinese telecoms official was more likely to be able to walk on water from Beijing to Taipei than to make an investment when he arrived in Taiwan. Things have changed. On April 29th China Mobile said that it would buy 12% of Far EasTone Telecommunications, a big Taiwanese mobile operator.

The size of the deal, a mere $526m, does not begin to convey its implications. In the aftermath of the announcement Taiwan's stockmarket shot up more than 15%, or about $60 billion in value, undeterred by rumblings from Taiwan's regulators that the deal violated a law preventing Chinese investment in Taiwanese telecoms firms. Given the security concerns associated with access to telecoms networks, it is a sensitive area for foreign investment—and you cannot get much more sensitive than China Mobile, which is directly controlled by a government that does not even accept Taiwan's territorial independence. Understandably, therefore, the deal will need government approval. Yet there is widespread confidence that it will be forthcoming, since the two companies would not otherwise have risked an announcement.

In retrospect, business ties between China and Taiwan began to shift in March 2008 with the election of a new Taiwanese government. Regular flights between the two countries resumed, after more than half a century, when the new government took office in May; the number of flights increased from 36 a week to more than 100 a week in December, and again to 270 from April 26th. Taiwan is pushing for the number to double yet again.

Along with closer ties in aviation and telecoms, several other potential agreements have come from the thaw between Taipei and Beijing, starting with direct discussions between Chinese and Taiwanese financial regulators on greater co-operation. Taiwan will also open up to direct Chinese investment in services, manufacturing, property and rail projects.

Taiwan has invested in China for decades, and by some reckoning more than 5% of Taiwan's population now lives on the mainland in order to do business there. But Taiwan itself has long felt that it was too small, and China too threatening, to allow reciprocal ownership. China tolerated this asymmetry because the Taiwanese provided capital and expertise that it lacked. In recent years, however, Taiwan's once-boisterous growth has ground to a halt, largely because investment and business has moved to the mainland. That has prompted growing calls within Taiwan for closer co-operation with China.

The most immediate benefit to Taiwan of opening itself up is financial. But some Taiwanese companies may also gain valuable access to the Chinese market. Its tie-up with China Mobile, for example, may give Far EasTone the right to allow its subscribers to roam onto China Mobile's network on the mainland, a potentially lucrative market given all that Taiwanese business travel. CLSA, a regional broker, reckons that the removal of barriers could prompt Chinese investment in many Taiwanese companies eager to do business on the mainland, including airlines, banks, shipping and technology firms.

This last group is likely to be the most controversial. Many of the Taiwanese technology companies that set up in China were attracted by its cheap labour, and to get through the door they were prepared to shift some expertise to the mainland. But the most advanced work in critical areas, notably semiconductors, remained in Taiwan. Such technology is the most appealing to the Chinese government, and to Chinese companies looking to invest in Taiwan. It is also what Taiwan will be most reluctant to give up.

The Taiwanese government is expected soon to release rules on what can be purchased and what must be protected. The telecoms investment suggests that the government will lean toward openness, but there will be limits. Controls will not be lifted altogether in the absence of a comprehensive trade agreement—and political concessions over sovereignty that neither side, for now, shows any sign of being ready to countenance.

Rolls-Royce

Keep on rolling

May 7th 2009
From The Economist print edition

The luxury carmaker launches a (slightly) cheaper model

DEEP in the West Sussex countryside, a stone's throw from the horseracing at "Glorious" Goodwood, the elegant home of Rolls-Royce Motor Cars, designed by Nicholas Grimshaw, seems a long way from the gut-wrenching turmoil in Detroit. But even Rolls-Royce and its wealthy customers—who in normal times wait up to six months for one of its handmade vehicles—are not immune to the financial crisis.

Last year was a record for Rolls-Royce since its reincarnation seven years ago under the wing of Germany's BMW. Despite the recession, it managed to sell 1,212 cars. Tom Purves, its chief executive (pictured), says he still hopes to match that this year, but admits it is unlikely. Rolls-Royces are built entirely to order and production of the Phantom and its drophead and coupé derivatives has just resumed at a rate of 25 a week after a five-week halt. Another pause is due in June, which Mr Purves hopes will be the last this year, other than the usual shutdown in August.

In these hair-shirt times, selling the ultimate statement of automotive luxury is tricky. Rolls-Royce's customers can still afford the £300,000 ($450,000) asking price. The problem, as Mr Purves acknowledges, is that for some buyers, the "atmospherics" of splashing out on such a conspicuous symbol of wealth do not feel quite right. The firm has data going back to 1904 that suggest there is no link between Rolls-Royce sales and either stockmarkets or GDP, but there is with property prices. In 2007 Beverly Hills was Rolls's best market, beating London, Dubai and Riyadh. But last year Beverly Hills was relegated to fourth place behind Beijing, with oil-rich Abu Dhabi claiming top spot. Mr Purves says that America accounts for about 40% of Rolls-Royce sales, and California was one of the first markets to soften.

Significantly, Mr Purves chose last month's Shanghai motor show to reveal that the new "baby" Rolls (bigger than any BMW 7-Series or Mercedes S-Class) will be known as the Ghost, after a car first produced in 1906. Stronger growth in emerging markets and the Ghost's arrival are likely to be the main fillip to sales next year.

Bloomberg News

Now you've seen a Ghost

Not only is the new car in a different price category from the stately Phantom—it will go on sale for about £170,000—but it is also aimed at the keen owner-drivers to whom Bentley (owned by Volkswagen since 1998) has successfully appealed in recent years. That said, despite more than 20 years spent selling BMWs, Mr Purves is adamant that no Rolls-Royce should be overtly sporting. "The qualities we must deliver," he says, "are silkiness and waftiness."

If the Ghost is a success, production will ramp up quickly in the last quarter of the year. By the end of 2010, if the world economy is showing signs of recovery, cars could be leaving Goodwood at a rate of 3,000 a year, two-thirds of them Ghosts. Although Mr Purves will not reveal the financial targets set by

BMW, Rolls-Royce should by then be at least self-funding.

Mr Purves is confident that Rolls-Royce can surmount the other obstacle in its path: public and regulatory disapproval of cars with hugely powerful engines. Unlike a Ferrari, for example, a Rolls-Royce is defined not by the sound its engine makes, but by silence and torque. Those, as it happens, are precisely the qualities of electric motors. A hybrid Rolls in the near future is a virtual certainty. Invoking the firm's founder, Mr Purves smiles: "I'm sure that Henry [Royce] would not have minded."

Time Warner and the internet

After the divorce

May 7th 2009 | NEW YORK
From The Economist print edition

Jeff Bewkes of Time Warner has a plan to save cable television—half of it, anyway

Bloomberg News

IN THE next few weeks an end may be announced to one of the great unhappy corporate unions. Time Warner, which span off its cable-operating business in March and has pruned its film-production outfit, is now trying to undo its eight-year partnership with AOL, an internet portal. Just as Time Warner moves to end one internet relationship, though, it is beginning another. Later this year the firm will test a scheme for putting programmes online that it calls TV Everywhere. Its cable channels such as HBO, which have so far kept their shows off the internet, will make them available online at no extra cost to people who can prove they subscribe to a cable or satellite package that includes the channel. Rival networks and cable providers have pledged to co-operate.

It is an attempt to preserve what is now plainly the core business of the slimmed-down Time Warner—and which also happens to be one of the most dependable rackets in media. Subscribers to multichannel television, who may get it from a cable, satellite or telecoms firm, pay for “bundles” of channels, whether they watch them all or not. They are also shown advertisements. Content providers like Time Warner receive carriage fees from the cable and satellite companies, which account for about half of their revenues (and the great majority for a premium channel like HBO). These fees are a handy bulwark against shocks to the advertising market, and they tend to go up faster than inflation.

At present the internet poses a puny threat to this commercial redoubt. ComScore, which tracks internet use, reckons the average American web user spends about ten minutes a day viewing online video, from water-skiing squirrels on YouTube to the latest episode of “Heroes” on Hulu. That compares with roughly 300 minutes spent watching live television. But the audience for online video is young and growing, the barriers that prevent people from piping it into their televisions are likely to fall and the broadcast networks are quickly moving online. On April 30th ABC, which is owned by Disney, became the third large broadcaster to make many of its programmes available free on Hulu. (Disney will also take a stake in the fast-growing online-video site.)

Time Warner does not want to row against this current. But neither does it want to be swept away. If the overriding fear a few years ago was that television might suffer the fate of the music industry, which failed to give consumers what they wanted and was ravaged by pirates, the worry now is that it will follow the newspaper industry, and give too much away. “The idea that it should be free and have no strings attached at all sounds very progressive,” says Jeff Bewkes, Time Warner’s boss. But once people are accustomed to having something free, it can be very difficult to persuade them to pay for it.

Any hitches to the TV Everywhere plan are likely to be less technological than commercial. Time Warner is not the only company with a scheme to put cable content online. Comcast, America’s biggest cable operator, is building its own system. It wants subscribers to be able to watch video on its website, Fancast. ESPN, a cable sports channel, already allows internet-service providers to stream some games.

An obvious threat, although not a present one, would come if a big video-streaming website started selling subscriptions to television programmes and other professionally produced content.

Such a move would transform the cable and satellite business. TV Everywhere, by contrast, aims to preserve its essential architecture. Carriage fees and bundling would remain. Stronger channels would continue to support weaker ones, and more popular programmes would support less popular ones. It is a potential solution to one half of the cable industry's worries about the internet. Which leaves the other half: compared with television, online-advertising revenues are meagre.

Hulu, the most impressive of the video websites, claims to charge advertisers somewhat more to reach a viewer than they would pay on a broadcast network during prime time. But Hulu runs just two minutes' worth of advertising in a 22-minute programme, about one-quarter of the load that TV viewers are expected to tolerate. For broadcasters, which derive nearly all their revenues from advertising, deciding to put new programmes on a site like Hulu involves a leap of faith.

Hulu's branding problem

Mr Bewkes points to another problem. Several cable channels, including CNN, Time Warner's news outfit, have painstakingly built brands that enable them to sell advertising at higher rates than they otherwise would. CNN also benefits by selling advertising across its TV channels and its popular website. Video-streaming websites are no respecters of brand. Hulu does not sell advertising on specific shows or networks; rather, it targets demographic groups. Lumping CNN's programmes in with other news on a video-streaming website may well devalue them.

For these reasons cable's early forays into the internet are likely to be messy. Content providers and cable operators may try to steer viewers to their own websites, like hucksters in a bazaar. This is unsatisfactory for customers, most of whom would probably prefer not to think too hard about the television programmes they watch, or where to find them. But at least it is a start.

Face value

Power struggle

May 7th 2009
From The Economist print edition

Will Anne Lauvergeon, the nuclear-energy industry's most tireless cheerleader, keep her job as boss of Areva?

Reuters

WHEN Anne Lauvergeon arrived in 1999 as the new boss of COGEMA, a French state-owned uranium-mining and fuel-recycling firm, it was at a low point. Nuclear power was so unpopular that some employees would not admit to working for the company. A friend told her taking the job would be professional suicide. When she first visited its headquarters, with decor unaltered since the 1970s—all chrome and dark-wood furniture, and long corridors of orange-laminated cupboards—she realised it would take a huge effort to drag the firm into the 21st century.

But Ms Lauvergeon believed in nuclear power and was convinced that it could be done. COGEMA became Areva after a merger with Framatome, a maker of nuclear reactors, in 2001. There was pressure to shut Framatome's main factory, but Ms Lauvergeon refused and it continued to operate "against the opinion of the world", as she puts it. Areva is now the only company to supply all stages of the nuclear-energy cycle, and it has expanded into America, Britain, China and elsewhere. It is in a unique position to benefit from nuclear's expected revival as a desirable low-carbon source of electricity.

Yet despite this turnaround Ms Lauvergeon faces a struggle to keep her job. Two things have recently gone badly wrong for her. Areva's flagship project to build a new type of nuclear reactor for Finland's main utility, Teollisuuden Voima Oyj (TVO), is late and over-budget, forcing Areva to set aside €1.7 billion ($2.4 billion) against profits up to December 2008. Areva and its partner, Siemens, a German engineering firm, agreed in 2003 to build the Finnish plant for a fixed sum of €3 billion—a price that was set too low, say those in the industry, so as to fend off rivals. Areva and Siemens blame TVO for the delays and extra costs, and the three firms are now embroiled in legal action. All this has raised doubts about Ms Lauvergeon's ability to oversee big industrial projects.

At home Ms Lauvergeon, who is known for her international profile and outlook, has strongly resisted government attempts to create a French nuclear-energy champion by merging Areva with Alstom, a French engineering firm. She argued that the merger lacked industrial logic and would alienate Siemens, with which Areva has had a joint venture since 2001. So it looked bad for her when Siemens abruptly said in January that it would exit the partnership. Worse, she received the news in an e-mail from Siemens, after the French government had been informed. Some question whether Ms Lauvergeon, a famously tough operator, managed the relationship smoothly. "She used Siemens against the government, but didn't treat the Germans well enough," says a person familiar with the situation. For its part, Areva blames poor Franco-German diplomatic relations for Siemens's exit.

Paradoxically some of Ms Lauvergeon's headaches may stem from her success in consolidating her power at Areva. It was as an adviser to François Mitterrand, then president of France, that she learnt the art of politics, securing the post at the age of 31, a few years after leaving the Ecole des Mines, a distinguished postgraduate engineering school. Ms Lauvergeon has managed to run Areva in a remarkably autonomous fashion over the past few years, insiders say. Having a government research body as her main shareholder may have given her far more freedom than private shareholders would have granted her. But it means the government is now unsure whether the situation in Finland is a one-off, or whether Areva's order book contains other nasty surprises that could damage the firm's profits.

On April 30th the government appointed Jean-Cyril Spinetta, chairman of Air France-KLM, as Areva's new chairman. It hopes Mr Spinetta, a respected industrial veteran, will be in a stronger position to oversee Areva than his predecessor. Mr Spinetta has much in common with Ms Lauvergeon: like her, he came to business in the traditional French manner, via the civil service, and both hail from the left. But that may make it easier for him to fire Ms Lauvergeon, as it would be impossible for her to blame party politics for the decision. Mr Spinetta is expected to conduct a thorough review of Areva's financial position and order book.

Vying with Nuclear Nicolas

Atomic Anne, as she is known in France, is nothing if not a survivor. Reports of her imminent removal proved exaggerated in 2006. But if she stays this time she may be forced into an important concession. Areva needs some €12 billion or so of extra funding over the next four years for its own investment plans and to finance the repurchase of Siemens's stake. A merger with Alstom is unlikely in the near term, mainly because Alstom could not afford it. But the government is said to want Areva to dispose of its electricity transmission-and-distribution division, which it was forced to buy for €950m as part of a rescue of Alstom in 2004. (It may now be worth €5 billion.) Ms Lauvergeon opposes a sale, arguing that the division helps Areva sell nuclear reactors. Instead she hopes that Areva will be allowed to launch a share offering. Nicolas Sarkozy backed this plan in 2004 when he was finance minister, she observes, though it was later cancelled. "We will have to see what he decides as president of France," she says.

Nobody doubts Ms Lauvergeon's achievement in helping to rehabilitate nuclear power. She is largely responsible for the lack of opposition to Mr Sarkozy's announcement last year, with little public debate, that France would build a second new reactor. The strongest opponents of nuclear power around the world, Ms Lauvergeon points out, are women; it may be that having a woman at the top of a largely male industry has helped. If Mr Spinetta does indeed unearth unpleasant surprises in Areva's books in the next few weeks, the industry could lose one of its most passionate advocates. Ms Lauvergeon's departure would also give utilities around the world more reason to worry about the cost and difficulties of building new nuclear reactors. Much depends, therefore, on whether Atomic Anne has got her numbers right.

Fiat's ambitions

The Italian solution

May 7th 2009
From The Economist print edition

Fiat’s chief executive, Sergio Marchionne, has gone merger mad

Reuters

HIS company is among the smallest of the global volume carmakers. But right now Sergio Marchionne is without question the most talked-about car executive in the world. The chief executive of Fiat Group has been alone in seeing an extraordinary opportunity in the meltdown in Detroit. By seeking to take over the running of both Chrysler and Opel, the European arm of General Motors (GM), Mr Marchionne is attempting not only to transform Fiat into a car group almost of the scale of mighty Toyota and Volkswagen (VW), but also to change the face of a perennially troubled industry.

Last December Mr Marchionne said of his stricken industry: “What we are seeing is unprecedented. I have never seen the failure of so many systems at once.” Fiat was in a fight for survival. “We’re just going to slam the brakes on, use as many temporary lay-offs as needed, cut everything back to essentials.” He added an apocalyptic forecast. “By the time we finish with this in the next 24 months, as far as mass producers are concerned, we’re going to end up with one American house [Ford or GM, you presume]; one German of size [VW Group]; one French-Japanese, maybe with an extension in the US [the Renault-Nissan alliance]; one in Japan [Toyota], one in China [several possible candidates] and one potential European player [either Fiat or PSA Peugeot Citroën].”

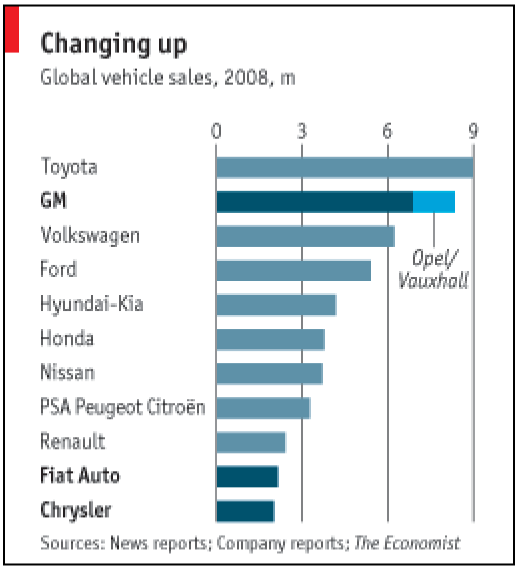
The details of this vision may be wrong. Despite its present travails and imminent bankruptcy, few believe that GM will vanish and leave Ford as the sole American-owned champion. France’s PSA Peugeot Citroën, though unwieldy, is not about to disappear either. The strength of Hyundai-Kia in emerging markets and North America should ensure that the South Korean producer makes the cut. And in Japan, however great the cull of smaller outfits such as Mitsubishi and Suzuki, Honda and perhaps Mazda will still be around to challenge the dominance of Toyota in its home market. So will Renault’s partner, Nissan.

But if the shake-up is likely to be less dramatic than Mr Marchionne expects, that is only because much of the industry remains addicted to wildly unrealistic market-share forecasts and value-destroying investments. Mr Marchionne thinks it has been living beyond its means for too long. “Out in front,” he says, “this business is glamorous like Las Vegas. But behind the scenes, the industrial machine is complex and chaotic. We just look round at what to invest in and it’s hard to justify the economics. To sort it out, you have to go back to the industrial machine and fix it.”

Critically, Mr Marchionne says, you need to sell in sufficient volume—about 1m a year on each platform—

to drive down costs. Take the platform for the VW Golf, which yields sales of more than 1.5m a year because VW also uses it for the Skoda Octavia, the Seat Leon and the Audi A3. About 75% of the cost of a car is in its architectural underpinnings. The rest goes on giving it a distinctive body and cabin, while honing the brakes, steering and suspension. Fiat gets sales of about 600,000 from its city-car A platform (the basis of the Panda, the retro-styled 500 and Ford's new Ka). But none of its other platforms comes close to what is required: the whole group sold only 2.15m cars last year (see chart). Mr Marchionne reckons the minimum for a volume maker competing in every sector is about 5.5m—leaving Fiat far from safety.

In the past Fiat has tried to get around this problem with various alliances. A tie-up with GM lasted for five years until 2005, when Mr Marchionne extracted $2 billion from the American firm to extinguish a put option that would have forced it to buy the then-sickly Italian company. Mr Marchionne believes that alliances are all very well, but they react too slowly and require too many compromises. Without speed, he believes, you are doomed.



Over the past year he has been developing a more ambitious strategy, at first constructed around Chrysler, but now including Opel. Cruelly mismanaged by Daimler during its decade of ownership, and too dependent on pickup trucks and an ageing line-up of SUVs, Chrysler was in no condition to withstand the storm. Its increasingly desperate management sought help from a host of other carmakers, including Fiat. It reached a tentative agreement in which Nissan would have made a small car for Chrysler and Chrysler would have built a pickup for Nissan. But that was the limit for Carlos Ghosn, under pressure as boss of the Renault-Nissan alliance.

Mr Marchionne came up with a plan that might win Chrysler the federal loans it needed to stay alive while getting Fiat much of what it wanted. In exchange for an equity stake of around 35%, Fiat would make available to Chrysler its small and medium-sized platforms and advanced, fuel-efficient powertrains. Chrysler would give Fiat some of the scale it was seeking for its platforms, joint purchasing of parts, some expertise in producing large cars, a distribution network in America and manufacturing capacity to build new Alfa Romeos and perhaps the Fiat 500 for the American market. As Mr Marchionne put it: "They have everything I don't have (including some I will never need) and I have everything they don't have and need."

But Mr Marchionne's scheme, which won the backing of the Treasury's car-industry task-force, went further. Although Fiat would initially get only a stake of 20% (rising to 35% after fulfilling criteria set by the Treasury) and would have to repay all Chrysler's federal loans before taking majority control, the Treasury accepted that Fiat should take over the responsibility of managing Chrysler and integrating the two operations as closely as possible.

Having presided over a near-miraculous turnaround at Fiat since being appointed in 2004, Mr Marchionne saw in Chrysler an opportunity to apply the same lessons. At Fiat he saw a sluggish organisation that lacked leadership and had become accustomed to management by committee. But he also saw, buried within the company, a new generation of leaders.

"The single most important thing was to dismantle the organisational structure," he recalls. "We tore it apart in 60 days, removing a large number of leaders who had been there a long time and who represented an operating style that lay outside any proper understanding of market dynamics." In their place he promoted a group of younger executives, many with a background in consumer marketing, who understood and could provide what he wanted: accountability, openness, rapid communication and impatience with hierarchy and internal politics.

AP

Marchionne, a man with a plan

Some doubt that Fiat's lean management has the resources to spread itself across Chrysler, let alone Opel too. Mr Marchionne understands the concern, but rejects it. He believes he already knows who the new leaders at Chrysler will be. He is confident that the same will apply to Opel, should that too fall into his lap.

Chrysler is essentially a done deal, although some uncertainty remains, not least because a few senior debtholders chose to push the firm into bankruptcy rather than accept the Treasury's offer of $2.2 billion on the $6.9 billion they are owed. Fortunately for Fiat, the bankruptcy court judge, Arthur Gonzales, this week rejected the lenders' argument that they had been treated illegally and cleared the way for Chrysler to emerge as a going concern within a couple of months. Mr Marchionne is preparing for the day: "We must act very quickly to cut overheads, lighten everything, speed up new models."

Nor has Mr Marchionne been twiddling his thumbs in Europe. Having insisted for weeks that he had made no direct approaches about GM Europe, on May 4th he went to Berlin to present the German government with a plan that would give Fiat control of much of Opel (which includes Vauxhall in Britain) and possibly Saab, GM's bankrupt Swedish unit. GM, which can no longer fund the lossmaking operations of its European arm, has been looking for a partner to take a majority stake in Opel since March. If it cannot find one, the German government will be loth to provide bridging finance. Fiat's main rival is a group consisting of Magna, a Canadian car-parts and engineering business, and Oleg Deripaska, a Russian oligarch.

As with Chrysler, Mr Marchionne will have to win over both government and unions. He says that the deal depends on the willingness of European governments, but chiefly Germany's, to stump up €5 billion-7 billion ($6.6 billion-9.3 billion) in bridging loans. In return, Mr Marchionne has promised to keep open Opel's three main assembly plants in Germany, although there are fears for factories in Belgium and Britain. Over time he intends to reduce combined capacity by 22%, but he says he will do so by slimming factories rather than closing them. It is, he says, the preferred way in Europe—but it will mean forgoing savings of about €250m a year.

Even so, combining Opel and Fiat could save at least €1 billion a year. Partly because of Fiat's shared history with GM, Mr Marchionne says that Opel fits perfectly. GM lacks an A platform, which Fiat has. They already share a B platform (for the Corsa and the Grande Punto) and Fiat would be happy to use Opel's excellent new C and D platforms. "We can achieve convergence on all the big platforms by 2012. Ultimately, I need to do this with Chrysler, but Opel gets me there much faster and with more immediate returns." Mr Marchionne adds: "I'm offering the German government a car business that will be effectively debt-free and I will take on Opel's liabilities, including pensions. I told them: if you have a better offer, take it."

If Mr Marchionne pulls it off, he will create a new company consisting of Fiat Auto (without Ferrari and Maserati or the rest of the Fiat Group), Chrysler and GM Europe. Among the probable stakeholders would be the Agnelli family (which controls Fiat), the United Auto Workers union health-care fund (until it cashes out) and GM. The rest of the equity would be sold in a public offering. In a normal year that combination could expect revenue of $100 billion from the sale of 6m cars—just above Mr Marchionne's viability threshold.

Others think that amalgamating three different cultures and several less-than-stellar brands is beyond even the formidably self-confident Mr Marchionne. The tale of Mr Ghosn is not wholly reassuring. It is now pretty clear that his heroic rescue of Nissan came at the expense of taking his eye off Renault, which in recent years has produced a succession of mediocre cars. This week Martin Winterkorn, the boss of

VW, pointed out that his company had been applying its vaunted platform strategy since 1992. “I wonder if he will be able to succeed,” said Mr Winterkorn, “because successfully managing several brands and obtaining true synergies is really difficult.”

Some see Mr Marchionne as an empire builder who has come to believe his own publicity. The charge exasperates him. “It’s just nonsense,” he says. “Fiat Group employs 200,000 people, but I’m going to carve out the car business and let the rest of it go its own sweet way. Look, I really hate the personal issue. It’s not about me, let’s just fix the industry. I’m only a conduit for change. You can’t just have Toyota on its own, we need this to guarantee survival. Now it’s up to others.”

American consumers

Off their trolleys

May 7th 2009 | WASHINGTON, DC
From The Economist print edition

Consumer spending may have hit bottom, but America's mountain of debt means the climb back up will be slow and painful

Illustration by Peter Schrank

CONFLICTING news this week from California, one of the centres of the housing bust. Just north of Los Angeles, a Texas bank was tearing down a half-built development of luxury houses that had fallen into its hands. With the market for flashy homes dead, the bank reckoned it made more financial sense to destroy them than to complete them.

Farther south, Jeffrey Mezger, boss of KB Home, a well-known LA-based home builder, was calling a bottom to his segment of the housing market. But KB Home's secret, he said, was to sell custom-built homes that were smaller and cheaper than before, and priced to compete with a flood of cut-rate foreclosure properties. "Homes must change with the times," he believes.

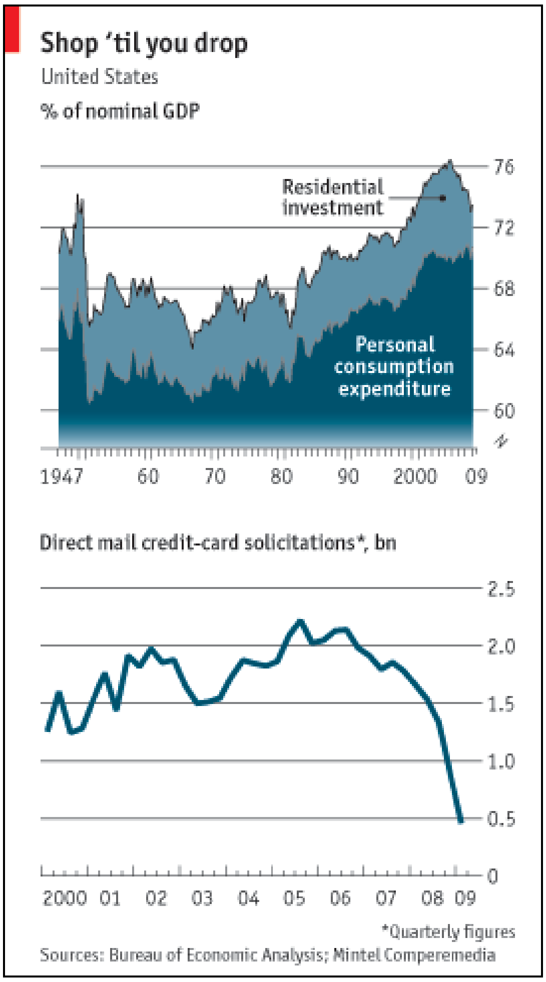
Whether it is for affordable homes or cheap goods, Americans are peering through the wreckage of the credit crunch and starting to buy again. After falling sharply in the second half of last year, consumer spending rose in the first quarter, and even sales of homes and cars have edged up from deeply depressed levels. Anticipating a rebound, shares of retail companies have soared.

Ben Bernanke, the Federal Reserve chairman, on May 5th characterised the news on consumers as "somewhat better". That cautious endorsement qualifies as downright ebullient compared with the pervasive gloom of a few months ago. A Fed survey of bankers, released on May 4th, gave a further hint of good news for consumers: though banks are still tightening standards on consumer loans, fewer of them are doing so than three months before. Meanwhile, there has been a long-overdue flurry of activity in the Fed's programme for restarting the securitisation market. On May 5th it supported the issuance of $10.6 billion of securities backed by student, car, credit-card, small-business and equipment loans.

But do not mistake the bottom for a vigorous rebound. Consumption may be growing again, but there is every chance it will remain depressed in coming years because of weak income growth, depleted wealth

and tightened credit.

Since the early 1980s, spending by households on goods, services and homes has grown faster than GDP, making it the locomotive of American—and global—expansion. By 2006 it accounted for 76% of nominal GDP, the highest since quarterly data begin in 1947 (see top chart).



This was accompanied by a steady decline in the personal saving rate and a rise in household debt relative to income. By itself, this was not a problem; household debt has risen relative to income since the 1950s, as a growing share of the population has taken out mortgages. Despite the higher debt burden, falling interest rates kept total household financial obligations—interest payments, rent and leases—within a range during the 1980s and 1990s.

An inflection-point occurred around 2000. Income growth stagnated but debts continued to grow rapidly, from 94% of income to 133% in 2007. The share of income devoted to servicing those obligations also jumped. A study in 2007 by Karen Dynan and Donald Kohn, both of the Fed, attributed that partly to more of the population reaching home-buying age, and mostly to a rise in home prices which made it possible to borrow more.

Financial innovation also played a role as the industry devised new ways for Americans to borrow against their homes. One manifestation was the plethora of credit-card offers to even marginal borrowers: more than 8 billion poured into Americans' mailboxes in 2006, according to Mintel Comperemedia, a consumer-research firm. From 2003 to the end of 2006, consumers borrowed almost $2 trillion against their properties via home-equity loans and "cash-out" mortgage refinancings. A dramatic reversal is now under way. Last year household wealth fell by 18%, or by $11 trillion. Macroeconomic Advisers, a forecasting firm, estimates the resulting negative "wealth effect" will depress consumption by 2% this year.

The financial crisis has killed off many of the loan products that had expanded access to credit during the boom. Subprime mortgages have disappeared and refinancings that deliver cash to homeowners are subject to stricter underwriting standards and higher fees. In the first quarter the credit-card industry sent out only a quarter as many solicitations as it did a year earlier (see bottom chart, above).

A more enduring restraint will be the pressure on consumers to reduce their debts to more manageable

levels relative both to income and to the much lower value of their homes. This effect is difficult to quantify, since so many factors determine consumers' preferred saving rates and levels of debt: assets, retirement goals, expected income, risk tolerance, access to credit, age, and so on. Some bearish analysts argue that debt ratios and saving rates ought to return to their levels of the early 1950s, but others reckon it would be enough to go back to 2000 for households to feel comfortable with their debts again.

This process, known as deleveraging, requires consumption to grow more slowly than income in coming years. A sudden rush to return debt ratios to where they were in 2000 would require ridding households of some $3 trillion in mortgage debt—an almost impossible task. More probably, mortgage debt will grow more slowly than income through a combination of lenders writing off impaired loans, homeowners paying down existing mortgages and new homeowners taking out smaller mortgages than in the past. Bruce Kasman of JPMorgan Chase estimates that the most dramatic phase of increased saving has already occurred, and spending will grow only a bit less than income.

But Martin Barnes of BCA Research, a financial-forecasting service, is more pessimistic. For debt to return to a more sustainable trend, real consumer spending would need to grow by just 1.3% a year from 2009 to 2013, the weakest such five-year stretch since the 1930s. It could grow even more slowly than that if taxes rise faster, he reckons, or if stagnant productivity impedes real-income growth.

This implies that for America to grow at a trend rate of about 2.5% something else will have to grow more quickly. Ideally that would be exports and investment. But given the torpor in the rest of the world, that will not be easy.

Buttonwood

Happy days are here again

May 7th 2009
From The Economist print edition

Investors' optimism has returned very quickly. Too quickly

Illustration by S. Kambayashi

MOST students suffer from pre-exam nerves. But the financial markets were remarkably sanguine ahead of the results of the stress tests of American banks (published after *The Economist* went to press). By the close of trading on May 4th, the S&P 500 index had regained all the losses it suffered earlier in the year.

Financial stocks have in fact been rallying ever since March, when Citigroup hinted that its trading performance in the first quarter had been better than expected. That optimism was borne out in other banks, albeit with the help of some one-off factors that may have overstated the underlying recovery in their finances. Big losses on commercial property and consumer debt are still to come. Nevertheless, the system has come a long way since the meltdown of last autumn.

That view is supported by the credit markets. The number of American banks tightening lending standards in the consumer and corporate-loan markets has fallen for two consecutive quarters. The three-month London Interbank Offered Rate (the price banks pay for borrowing in the money markets) has fallen below 1% for dollar loans, having been almost 5% in the autumn. Investors in high-yield bonds, the riskiest form of corporate debt, enjoyed returns of 11.5% in April.

In short, there seems to have been a huge shift in attitudes towards risky assets. That can be seen at the sectoral level as well as in the overall market. The rally has been led by cyclical stocks, those that are most dependent on economic growth. By the end of April mining, automobile, engineering and general-retail stocks were all up on the end of 2008, whereas defensive sectors such as food producers, pharmaceuticals and utilities were down.

This economic optimism has largely been justified by the data, notably by the purchasing managers' surveys of both manufacturing and services. In truth, the data suggest only that the economy is contracting at a slower pace than before. Nevertheless, the figures seem to point to a deepish recession, rather than the rerun of the Depression that was feared a few months ago.

All told, this looks like a conventional rally from the depths of a recession. Stockmarkets usually advance before a downturn is over, anticipating the recovery in profits to come. Optimists point to America's first-quarter results, in which 66% of reporting companies beat expectations, according to HSBC.

The trouble with this picture is that it all seems too neat. Bear markets are normally pitted with some vigorous rallies, as investors in Japan have discovered over the past 20 years. Often these rallies result from the technical position of investors, and this may be another example. After their battering in 2008, many hedge funds entered the year either betting against the market (going short) or holding large cash positions. As the market has rallied, those funds have had to chase it higher, thereby giving the rebound stronger impetus.

The economic data may have improved, but only from some terrible lows. It would have been amazing, given the amount of stimulus thrown at the economy in the form of lower oil prices and interest rates, quantitative easing and fiscal deficits, if there had not been some kind of rebound.

Nevertheless, an observer who had woken after sleeping for the past two years, would be alarmed at the numbers. Nominal GDP in America has fallen for two consecutive quarters for the first time in more than half a century. Industrial production is still dropping at a double-digit annual rate in America, the euro zone and much of Latin America and South-East Asia.

Companies are still defaulting on their debts at a steady rate; 40 issuers did so in April and Moody's expects the default rate to reach 14.3% by next March. Even the results season has been mixed. Andrew Lapthorne at Société Générale points out that 62% of American companies have missed expectations for sales. That implies the profit improvement is coming from higher margins, something that it is hard to believe can persist given the economic backdrop.

The danger is that sentiment has flickered higher rather as a dissected frog's leg will twitch when an electric current is applied. The world is still drowning in debt, unemployment is still rising, wages are stagnant and the threat of higher taxes hangs over consumers. This was not a conventional downturn; it is unlikely to herald a conventional recovery.

Award: Philip Coggan, our Buttonwood columnist, won the title of Senior Financial Journalist of the Year at the Harold Wincott Press Association Awards for 2008.

American banks

Who's in charge here?

May 7th 2009 | NEW YORK
From The Economist print edition

Stress tests will gauge the government's resolve to take on Wall Street

TOO cosy with Wall Street during the boom, too soft on it in the bust. This week brought an opportunity for the American government to prove this characterisation wrong with the release of the results of stress tests on 19 large banks, after *The Economist* had gone to press.

Despite complaints that the tests lacked spine—the worst case envisaged by regulators no longer looks far-fetched—it was clear days before the results that several of the banks would be ordered to plump up their equity cushions. Last-minute leaks suggested the booby prize would go to Bank of America (BofA), which fell $34 billion short of the level considered safe.

The test results will set off a scramble to plug the gaps exposed by regulators. In theory, banks have six months to do this. But markets will not be that patient. BofA will hope to raise billions through share offerings and asset sales; it may offload its stake in a Chinese bank. It may also convert the government's preferred stock into the more respectable common sort, leaving the taxpayer with a large stake.

The healthiest banks, such as JPMorgan Chase and Goldman Sachs, will just as quickly unveil plans to free themselves from various restrictions by buying out the government, which invested billions of dollars in them last year at the height of the crisis. Only banks that can show they no longer rely on a federal debt-guarantee programme, under which they have collectively raised $330 billion, will be allowed to do this, officials said on May 6th.

The test results come amid a wave of criticism that policymakers have not been as tough on Wall Street as they should have been. Accuser-in-chief is Simon Johnson, a former IMF chief economist, who has portrayed Wall Street as an oligarchy that has left a generation of politicians and regulators "mesmerised" and loth to upset it.

This capture is partly financial: the top 25 subprime-mortgage originators, many with ties to big banks, have spent close to $380m on lobbying and campaign contributions over the past ten years, according to the Centre for Public Integrity, a non-profit organisation. It is also cognitive: senior economic officials have spent so much time in and around Wall Street over the years that they can no longer distinguish between the interests of big banks and those of the public. Officialdom "can't envisage a world without big, powerful dealers", says Christopher Whalen of Institutional Risk Analytics, a research firm.

Indeed, for all the fretting over banks that are "too big to fail", the big have got even bigger. Banks have been "subsidised in becoming more economically and political powerful", writes Thomas Hoenig, president of the Federal Reserve Bank of Kansas City. This influence extends into the Fed itself. Stephen Friedman, chairman of the New York Fed and a Goldman director, received a waiver that let him keep his Goldman shares, and buy more, after it became a bank holding company.

Moreover, the government has so far been reluctant to wipe out shareholders, penalise creditors or kick out tainted bosses, such as BofA's Ken Lewis—though it says sackings may yet be in order. Asset guarantees have been offered at below-market rates, and the administration's toxic-asset plan was largely shaped by the financial sector. Banks were even given a chance to challenge the findings of the stress tests.

The legislative picture is more patchy. Banks have seen off a mortgage "cramdown" bill that would have let judges write down principal. But they are resigned to tough credit-card reforms, which will cost JPMorgan Chase alone an estimated $500m a year. Other bank-unfriendly bills include Barack Obama's proposed shake-up of offshore taxation.

Moreover, government-backed banks are vulnerable to arm-twisting: four of them accepted a mere 29 cents on the dollar for their debt in Chrysler's restructuring. If the government can persuade markets that

it has been equally tough in stress-testing the banks themselves, it will go some way towards silencing those who accuse it of wearing kid gloves when it should be wielding an iron fist.

German finance

The sick banking system of Europe

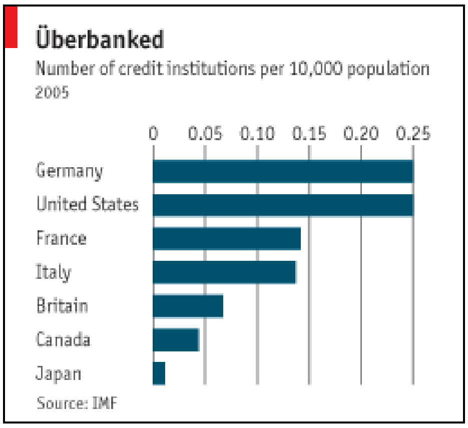
May 7th 2009 | BERLIN
From The Economist print edition

The financial crisis provides a chance to fix Germany's state banks

PERSONAL greed is often the explanation given for the disastrous forays of the world's banks into America's subprime mortgages. In Germany, however, many of the worst decisions were made not by the bonus-driven crowd in Frankfurt but by ostensibly well-intentioned public servants in the country's public banks, or Landesbanken.

The extent of the damage wrought on the Landesbanken, most of which are owned by state governments and local savings banks, was revealed late last month in a leaked document that was published by the *Süddeutsche Zeitung*, a newspaper. It said that the financial regulator, BaFin, reckoned that German banks—mostly Landesbanken—held €816 billion ($1.1 trillion) in toxic securities. On May 6th five Landesbanken had their ratings cut by Standard & Poor's.

So deeply in debt are the hardest-hit of this unwieldy bunch that only the central government has the cash to prop them up. Yet instead of lamenting, many in Berlin see this as the first opportunity in decades to fix a banking system that is plagued by fragmentation and poor profitability. The main problem facing German banks is that there are too many of them. The country has more than twice as many banks relative to its population as countries such as Britain, Canada and Japan, according to the IMF (see chart). The intense competition for customers means that they are far less profitable in Germany than in the rest of Europe, according to Moody's, a rating agency.



In an open market, profitable banks would solve this problem by swallowing their weaker rivals. Yet in Germany this has not happened because state governments have blocked takeovers of public banks and many savings banks have also been protected by law.

Government guarantees are also to blame. Until 2005 the debts of Landesbanken were backed by state governments. This allowed the public banks to borrow and lend more cheaply than privately owned institutions. New guarantees have since been banned, but before the prohibition came into force, Landesbanken were allowed to load up with debt (the debt does not mature until 2015). Moody's reckons that they still have as much as €300 billion of guaranteed loans on their books. Much of this was used to fund subprime securities.

The weaknesses in Germany's banking system have long been a worry for the federal government. In talks with the IMF last year both sides agreed that the country's fragmented banking system posed huge risks. Yet most of the government's efforts to get Landesbanken to merge have been stymied by the states, which have proved reluctant to lose control of their wards.

Now change may finally be forced on the Landesbanken by adversity. The central government controls the purse strings of a federal bail-out fund, and it is understood to have made consolidation a condition for offering help with toxic assets. People familiar with the plan expect the number of Landesbanken to shrink to between two and three, from seven now.

Consolidation of these public banks would be a useful first step, but better still would be the tougher job of privatising them and of merging the country's savings banks. Germany should also take a hard look at how its pre-2005 guarantees of public banks encouraged them to behave recklessly. The lessons it learns may prove useful to governments around the world that are now having to stand behind the debts of their banks to stop them from collapsing, while at the same time desperately trying not to sow the seeds of the next financial crisis.

Infrastructure

Ports in a storm

May 7th 2009
From The Economist print edition

Heavy debts and light volumes test a supposedly stable asset class

ONE by one, the claims made by modern finance have been tested during this crisis and usually found wanting. The merits of infrastructure investment are the latest to come under scrutiny. Infrastructure assets—roads, airports, utilities and the like—are supposed to provide stable if unspectacular long-term returns that are relatively immune to the peaks and troughs of the economic cycle.

That assumption is being tested by the severity of the economic downturn. On May 5th BAA, the main operator of British airports, reported a 10% fall in passenger volumes at its three London airports in the first quarter of the year, on a par with the drop it saw after the terrorist attacks on September 11th 2001. Ports on the west coast of America have suffered huge declines in volumes of container traffic. “Revenue is not as sticky as once thought,” says the head of a large infrastructure fund.

For long-term investors such as pension funds or sovereign-wealth funds, surely even the most precipitous short-term declines ought not to matter much? But pre-crisis enthusiasm for infrastructure assets created two vulnerabilities. One was that some investors strayed into areas that Colin Smith of PricewaterhouseCoopers, a consultancy, calls “infra-lite”—assets that are more volatile and less protected by barriers to entry than essential infrastructure. Think of toll roads that can be bypassed, such as the gloriously empty M6 in Britain. Many expect investors to focus more narrowly in future on core assets where returns are heavily regulated (water companies, say) or based on availability rather than usage (for example, social infrastructure such as schools and hospitals).

The second weak link is the amount of leverage that many investors took on. Dips in revenue can be painful even for conservatively geared firms because infrastructure businesses tend to have high fixed operating costs. But they particularly hurt investors that levered up in the good times and now have to keep creditors at bay.

PA

Please fasten your seatbelts

Crushing debts suffocated Babcock & Brown, an Australian investor that went into voluntary administration in March. BAA’s pre-tax first-quarter loss of £316m ($462m) resulted partly from increased interest payments after a refinancing last year. It needs to get a decent price for Gatwick airport, which it must sell on competition grounds, to reduce its debt burden.

This is not a seller’s market, however. Cheap money helped buyers to bid ever higher during the boom. Lenders are now pulling back. The planned privatisation of Midway airport in Chicago, which would have been the first such deal in America, collapsed last month after the winning consortium (whose members included Citigroup, which really ought to have known better) found that it could not finance its lavish bid. Many suspect that the deal will eventually be revived but at a much lower price. Macquarie, an Australian infrastructure pioneer that reported a steep fall in profits on May 1st and promptly raised more capital, is also feeling the effects of frozen credit markets. An independent analysis by Deloitte this month endorsed a lowish bid for Macquarie’s MCG communications fund from the Canada Pension Plan Investment Board

because of MCG's ugly refinancing burden.

Falling prices are good for investors who do not have to worry about creditors. Preqin, a data provider, reckons that infrastructure funds are sitting on $65.5 billion of uninvested equity. Record amounts of fund-raising—95 unlisted funds are on the road at the moment, targeting more than $100 billion of capital—would bolster the war-chest. Some government-stimulus money is earmarked for infrastructure, although it is unclear how the extra spending will feed through to private investors. The second-order effects of yawning deficits may prove more important, as governments unload assets in an attempt to balance their books. In infrastructure as in every other asset, cash is the best defence and the greatest source of opportunity.

Banks in the Gulf

Shifting sands

May 7th 2009 | DUBAI
From The Economist print edition

A flurry of consolidation is coming

WHEN the oil price was sky high all banks in the Gulf shared in the same good fortune. Its drop has exposed different flaws in each country. Kuwaiti banks have been crushed by property loans, in Bahrain they lack liquidity, and banks of the United Arab Emirates (UAE) are undercapitalised and inefficient.

They all have one thing in common, however. They are tiny. They may inhabit hubristic skyscrapers, but the largest bank in the region, Emirates NBD, has assets worth just $75 billion, puny even compared with the shrunken trillion-dollar balance-sheets of its Western counterparts. Worse, the region is overbanked. The UAE alone has 52 banks. Most lack economies of scale and access to international capital markets, despite being vital to the region's commerce.

The obvious solution is consolidation and it is coming, according to a new report from the largest Saudi bank, NCB. A case in point: Al Salam bank of Bahrain last month offered to buy Bahrain Saudi Bank (for the princely sum of 27m Bahraini dinars, or $71.6m). Dubai's ruler has combined his two investment arms, Dubai Group and Dubai International Capital, and he sanctioned the merger of Amlak and Tamweel, two big home lenders.

Rumoured to be next on the list is a possible 28 billion dirham ($7.7 billion) merger of Abu Dhabi's second- and third-largest banks. This could be a further boost to the emirate, which has already come to the rescue of its debt-laden neighbour, Dubai.

Banking consolidation has long been talked about in the Gulf—to little avail. But this time, the crisis means there may finally be enough pressure to force reluctant family owners to part with their trophies. Kuwait's Gulf Bank, for example, is looking for a buyer after losing more than $1 billion on derivatives. Global Investment House of Kuwait is badly hit too, and Shuaa Capital, Dubai's biggest investment bank, has had a torrid time.

"Distress breeds consolidation opportunities," as Rachel Ziemba of RGE Monitor, a consultancy, wryly puts it. So does the continuing rise of *sharia*-compliant Islamic banks. They are still the underdog—though not, perhaps, for much longer. Last month as part of a trend to create hybrid banks, National Bank of Kuwait declared its intention to buy 40% of Boubyan Bank, an Islamic lender. Conventional lenders fear being left high and dry by moves to patch together the fragmented Islamic market. They also worry about competition from Istikhlaf, a new $10 billion Islamic super-bank expected to launch an initial public offering in December. It could be the world's biggest Islamic bank.

Despite all this, merger plans may be thwarted by the timidity of local rulers. Tristan Cooper of Moody's, a rating agency, says many sheikhs fear the social consequences of too many local staff being laid off as a result of consolidation. However much banks may want to cut costs, rulers are reluctant to remove regulatory hurdles lest they cause unrest. One banker quips that there may be no porcupines in the Gulf but its banks have to mate like them. Very carefully.

Canada-EU trade talks

A 60-year-old dream

May 7th 2009 | OTTAWA
From The Economist print edition

Trade talks between Canada and the EU send a worrying signal about Doha

WHEN NATO was under negotiation in 1949 Canada wanted to create not just a military alliance, but a transatlantic economic and political union too. The heft of the larger European countries, it reasoned, would restrain the growing clout of the United States. Rebuffed, Canada was drawn firmly into America's orbit. Sixty years on it has come back with a scaled-down plan, starting talks on May 6th with the EU aimed at a bilateral trade agreement.

You can see why Canada would want to lessen its dependence on America, which bought 75.5% of its exported goods last year and provided 63.4% of its imported ones. Yanked into recession by America, Canada worries that trade will suffer from protectionism (in the form of new Buy American provisions and country-of-origin labelling requirements on farm products) and Washington's moves to toughen up border security.

It is less clear what motivates the EU, which traded a mere €70 billion ($103 billion) with Canada last year. The EU did more than five times as much trade with China in 2007 and more than ten times as much with America. The estimated increase in bilateral trade of €25 billion annually once the deal has been in place seven years appears modest.

According to Catherine Ashton, the EU trade commissioner, by talking about trade liberalisation amid rising global protectionism, the two parties are sending a "powerful signal". Yet they are also sending a worrying message about confidence in the Doha round of global trade talks. In 2006 Canada and the EU had put talks on a trade and investment treaty on hold pending the outcome of Doha.

AFP

Sealed with a loving kiss?

Starting talks is easier than finishing them. Most Canada-EU goods trade is already tariff-free, which means the barriers left standing, such as those on farm products, are the hardest to knock down. And there is always the danger that small trade spats, such as the one touched off on May 5th when the European Parliament voted to ban the import of seal products, could fester and infect the broader talks.

Still, the prospect of a successful outcome caught the attention of American business. The National Association of Manufacturers called on the Obama administration to negotiate a United States-EU agreement or risk being the only partner in the North American Free-Trade Agreement left out (Mexico signed one in 2000). That 60-year-old Canadian dream of stronger transatlantic economic ties may yet come true.

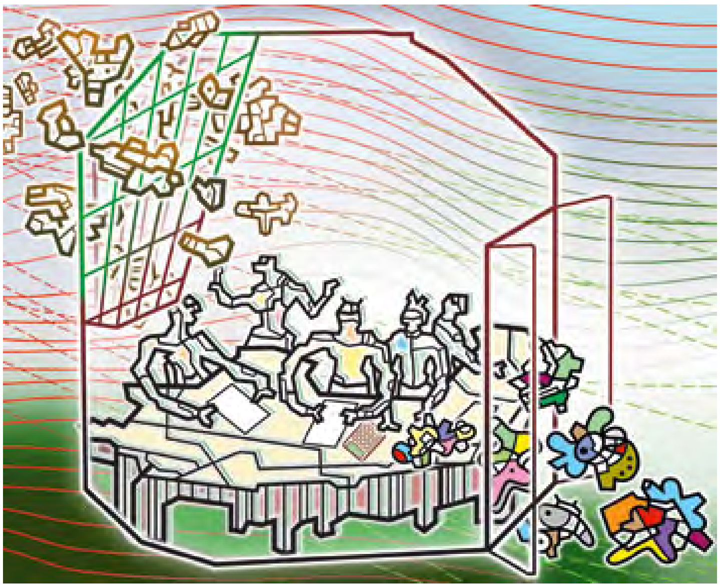
Economics focus

Opening the floodgates

May 7th 2009
From The Economist print edition

Imports can be as useful to developing countries as exports are

Illustration by Jac Depczyk



PAUL KRUGMAN, who won last year's Nobel prize in economics for his work on trade, wrote in 1993: "What a country really gains from trade is the ability to import things it wants. Exports are not an objective in and of themselves; the need to export is a burden that a country must bear because its import suppliers are crass enough to demand payment."

This view does not dominate the public debate. Most are thrilled by the idea of export growth, but cower at the prospect of more imports. Such prejudice certainly prevailed in India in 1991, when the IMF foisted tariff cuts on the economy as one of the conditions attached to a $2.5 billion bail-out package. Pessimists fretted that a flood of imports would destroy Indian industry.

For a group of American economists*, however, that sudden trade liberalisation has provided an unusually clear lens through which to study the way that commerce affects the economy. This is precisely because it was externally imposed. That the government had to hew to the IMF's diktats and slash tariffs across the board gave industries little scope to jockey for exemptions. This made the researchers confident that tariff cuts, and not differences in industries' ability to lobby the government, were responsible for changes in India's trade patterns after liberalisation.

As part of those reforms, India slashed tariffs on imports from an average of 90% in 1991 to 30% in 1997. Not surprisingly, imports doubled in value over this period. But the effects on Indian manufacturing were not what the prophets of doom had predicted: output grew by over 50% in that time. And by looking carefully at what was imported and what it was used to make, the researchers found that cheaper and more accessible imports gave a big boost to India's domestic industrial growth in the 1990s.

This was because the tariff cuts meant more than Indian consumers being able to satisfy their cravings for imported chocolate (though they did that, too). It gave Indian manufacturers access to a variety of intermediate and capital goods which had earlier been too expensive. The rise in imports of intermediate goods was much higher, at 227%, than the 90% growth in consumer-goods imports in the 13 years to 2000.

Theory suggests several ways in which greater access to imports can improve domestic manufacturing. First, cheaper imports may allow firms to produce existing goods using the same inputs as before, but at a

lower cost. They could also open up new ways of producing existing goods, and even allow entirely new goods to be made. All this seemed to hold in India. For example, its prolific film industry had continued to make some black-and-white films into the 1970s, in part because of the difficulty of importing enough supplies of colour film. But proving whether the theory applies in practice requires more detailed data, not just about how much firms produced but what they produced, and how all this changed over time.

Most attempts at addressing these questions have foundered because such information is not available. But with India, the researchers were helped, perversely enough, by highly restrictive industrial policies that the country had introduced in the 1950s. These included rules that required companies to report to the authorities every little tweak to their product mix—a burden for firms, but a gold mine for researchers. Happily, the economists found that the data backed up the theory: lower import tariffs did lead to an expansion in product variety through access to new inputs. They found that about 66% of the growth in India's imports of intermediate goods after liberalisation came from goods the country had simply not bought when its trade regime was more restrictive. These new inputs caused the price of intermediate goods to fall by 4.7% per year after 1989. And detailed data linking inputs to final goods showed that the imports led to an explosion in the variety of products made by Indian manufacturers; the average firm made 1.4 products before liberalisation, but by 2003, this had increased to 2.3. The increases in variety were largest for industries where the input tariffs were cut most, and these industries also saw increased spending on research and development. Overall, the new products that Indian companies introduced were responsible for 25% of the growth in the country's manufacturing output between 1991 and 1997.

Slash and churn

But one aspect of India's experience after trade liberalisation did not conform to what the researchers had expected. Normally, as new products are introduced, some older ones stop being made. This "churn" in the market is part of what makes people uncomfortable about lower trade barriers, because it may cause difficult adjustments for some workers or companies. But the Indian variant of creative destruction seemed unusually benign. The researchers found that firms rarely dropped products. One reason for this may be the diversity of India's economy: there is always a segment lower down the economic pecking order which is happy to buy products that richer consumers scoff at.

This may be unique to countries like India where many levels of development co-exist. But Penny Goldberg, one of the authors, thinks that the methods used in the studies on India can be applied to many other countries where trade has been similarly liberalised and which have good data on firms, such as Colombia and Indonesia. She notes that one of her co-authors, Amit Khandelwal, visited a Coca-Cola bottling plant in China, and noticed that all the machinery was either Japanese or German. China, of course, is known as a big exporter. But it may never have achieved this success without access to a range of imports.

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*"Multi-product firms and Product Turnover in the Developing World: Evidence from India", by Penny Goldberg, Amit Khandelwal, Nina Pavcnik and Petia Topalova. (Forthcoming in the Review of Economics and Statistics.) Other papers available at http://www.princeton.edu/~pennykg/

Global health

Preparing for the worst

May 7th 2009 | NEW YORK
From The Economist print edition

Vaccine makers are ill-prepared for an influenza pandemic

Getty Images

MEXICO CITY sprang back to life this week after two weeks of fear and inactivity. Officials shut down most of the economy to halt the spread of a previously unknown strain of the mongrel H1N1 virus, which is comprised of avian, swine and human influenza viruses. The hope is that the outbreak has now peaked.

If so, that will come as a relief to many, as the virus has spread rapidly around the world. On May 6th the World Health Organisation (WHO) reported 822 confirmed cases in Mexico, including 29 deaths. Altogether, 403 cases have been detected in the United States, including at least one death. Dozens of non-lethal cases have been found in 22 other countries. If a cluster of self-sustaining cases in a region outside the Americas is confirmed, the WHO will raise its concern from level five to the top of its six-level scale for global pandemics.

Richard Besser, the acting director of America's Centres for Disease Control (CDC), said the virus "so far is not looking more severe than a strain that we would see in seasonal flu." That is not as reassuring as it sounds. An influenza outbreak in 1918 began in a mild way, but returned in a lethal form months later and killed millions. Margaret Chan, the WHO's boss, cautioned: "it may come back…the world should prepare for it."

One of the best ways to do so is vaccination. Surveillance systems and antiviral treatments will help contain a disease, but they cannot halt it the way a vaccine could. Such a treatment would have to come from the makers of vaccines for the more ordinary, seasonal strains of flu. Yet despite all the advances in biological science, this industry still relies on capital-intensive, inflexible and old-fashioned technologies, such as producing vaccines from millions of chicken eggs.

The drift and shift

The production of flu vaccine has developed to cope with seasonal flu. The disease may seem no more than a nuisance to many, but the flu still kills perhaps 500,000 people a year around the world. It is hard to develop a perfect vaccine against seasonal influenza because it is so fleet-footed. There are usually several different strains of influenza active at any time, and these variations evolve. Alan Barrett of the University of Texas says travel by carriers of influenza, be they people in aeroplanes or birds on the wing, means regional mutations quickly spread around the world. Hence, even when flu subsides at the end of

the northern hemisphere's winter, the disease merely shifts to the southern hemisphere (which is now entering its winter). Six months later, it moves back. When the mutations are gradual, as with seasonal flu, it is known as drift; when they are abrupt, as with the new strain of H1N1, you have a shift on your hands.

To help the vaccine manufacturers plan, the WHO issues guidelines every six months listing the three strains of seasonal flu that appear to pose the biggest threat during the relevant hemisphere's approaching winter. The firms then prepare their genetic cocktails and develop them inside live chicken eggs in sterile conditions. The resulting "trivalent" vaccine provokes the patient's immune system into producing antibodies, and that primes it for an attack by the worrying strains of flu.

The final product comes in two forms. Most of the world's flu vaccine is a killed virus, given as an injection; Europe's Sanofi Pasteur and Novartis are leading producers that use this approach. America's MedImmune has come up with a nasal spray that uses a live flu virus in a weakened form. Both methods use lots of eggs.

If a global pandemic is declared and manufacturers are asked to produce a vaccine for H1N1, they are unlikely to be able to respond quickly enough. Firms can produce perhaps a billion doses of seasonal vaccine every year. The details of dosing for a pandemic vaccine are not yet known, but it is clear that even if all the capacity was switched to pandemic flu there would still be a huge global shortfall. Keiji Fukuda of the WHO summed it up this way: "There's much greater vaccine capacity than there was a few years ago, but there is not enough vaccine capacity to instantly make vaccines for the entire world's population for influenza."

Switching production also poses risks. A lack of vaccines for seasonal flu guarantees that many unprotected people will die of the otherwise mundane version of influenza. Nor is there any guarantee that, having switched production, a second wave of an H1N1 strain will indeed be deadly. So producing pandemic vaccines as a precaution may turn out to be a waste of resources with deadly results. Or it may save millions of lives. No one knows.

The main problem is that egg-based manufacturing cannot mount a rapid response. It could take only a few more weeks for the WHO and CDC to develop a "seed" strain of the pandemic virus, but experts say producers would then need four to six months before they could create large volumes of vaccine.

Could more innovative manufacturing techniques help? One promising approach involves growing vaccines not in eggs but in cell cultures, which is speedy and easily scaled up. Another is to add adjuvants, which are catalysts that improve the efficacy of a vaccine and reduce the amount of active ingredient required.

A number of companies have been hoping to get such technologies to the market by 2011 or 2012, and some might be able to help with any shortfall should there be a pandemic later this year. Anthony Fauci, head of America's National Institute of Allergy and Infectious Diseases, says the American government has been funding many such firms in preparation for bioterrorism and pandemics. But he points out that none of the firms has so far got a pandemic flu vaccine past safety trials. "They are not ready for prime-time," he says.

Yet desperate times may lead to desperate measures. Cell-based manufacturing is already used to make vaccines against many other diseases, so it might win rapid approval for flu. European regulators have been more enthusiastic than American ones about allowing adjuvants in flu vaccines. Mexican officials are reportedly in discussions with biotech firms to build flexible vaccine-facilities quickly. The WHO this week called such novel approaches a risky "leap of faith". But if a crisis does engulf the world, that may be a leap some are willing to make.

Animal testing

Suffering for science

May 7th 2009
From The Economist print edition

Europe votes for better regulation of animal experiments

FIFTY years ago, William Russell, a classics scholar, and Rex Burch, a microbiologist, outlined how the use of animals in scientific research could be made more humane. They wanted scientists to restrict the use of animals, to refine their experiments to minimise distress and to replace testing on animals with alternative techniques. Although the "3Rs" have become a guiding principle, the number of animals used today remains far higher than Russell and Burch would have accepted. Finally, that may be changing. On May 5th the European Parliament voted to update the rules on the use of animals in research.

Alamy

Experimental subject with no vote

Some 12m animals are used in scientific procedures each year in Europe. Most are mice and rats. The European directive on how such animals should be treated dates from 1986, long before research led to the breeding of the first creatures that carried the genes of another species. Some countries have more restrictions than others. Britain, for example, uses far fewer primates in scientific research than does France. The European Commission said in November 2008 that it wanted to update the rules to better protect laboratory animals throughout Europe. It received hundreds of amendments, but has adopted few of them.

In particular, the politicians decided against an outright ban on the use of great apes. Instead they voted to allow such experiments only when they are intended to conserve the number of chimpanzees, bonobos, gorillas and orang-utans, or when using these species becomes essential to tackling a disease that threatens people. In practice, no great apes have been used in Europe for years and there are no breeding colonies from which to take them. In America, chimpanzees are being used to develop a vaccine for hepatitis C because they are the only creatures, other than humans, to be afflicted by the disease.

Another proposal was to ban the use of primates caught in the wild. Scientists prefer to work with the offspring of animals raised in laboratories because knowledge of the creatures' complete medical history makes them more dependable. The commission will investigate whether breeding colonies can be established within the next decade for all species used in research. Every other year, it will also conduct a review of the use of primates, mostly macaque monkeys, in research. Less than 0.1% of the animals used in research in Europe are primates.

All experiments will be classified according to the degree of pain and distress they cause. If mild or moderate, animals can be used again. Those that experience severe pain will be killed. The legislation would allow mild procedures to be approved by an employer. But those causing moderate or severe pain would need the permission of a national authority.

Sharing information freely should help to reduce the number of animals scientists use. Today they usually

publish the results of their research only if they are positive, but if there is more data about negative results, scientists are less likely to repeat experiments needlessly.

The commission also agreed to expand the work of the European Centre for the Validation of Alternative Methods to develop, co-ordinate and promote procedures that can replace animal testing. That is important because, at present, the centre concentrates on toxicology tests that account for only about 10% of animal experiments in Europe, whereas most animals are used in basic medical research. Any alternatives in Europe will need to be accepted by authorities worldwide to avoid animal tests being imposed elsewhere.

With elections for a new parliament soon to take place, MEPs are unlikely to see the reform through until at least 2010. It will then be up to member states to adopt the legislation, which could take another couple of years. Russell and Burch would have been pleased that progress is being made, but appalled at its slow pace.

Electric cars and noise

The sound of silence

May 7th 2009
From The Economist print edition

Sound generators will make electric and hybrid cars safer

WHEN cars run on electric power they not only save fuel and cut emissions but also run more quietly. Ordinarily, people might welcome quieter cars on the roads. However, as the use of hybrid and electric vehicles grows, a new concern is growing too: pedestrians and cyclists find it hard to hear them coming, especially when the cars are moving slowly through a busy town or manoeuvring in a car park. Some drivers say that when their cars are in electric mode people are more likely to step out in front of them. The solution, many now believe, is to fit electric and hybrid cars with external sound systems.

A bill going through the American Congress wants to establish a minimum level of sound for vehicles that are not using an internal-combustion engine, so that blind people and other pedestrians can hear them coming. The bill's proponents also want that audible alert to be one that will help people judge the direction and speed of the vehicle. A similar idea is being explored by the European Commission.

Although there is little data on accidents, the latest research suggests there is cause for concern. Vehicles operating in electric mode can be particularly hard to hear below 20mph (32kph), according to experiments by Lawrence Rosenblum and his colleagues at the University of California, Riverside. Above that speed the sound of the tyres and of air flowing over the vehicle start to make it more audible.

The researchers made sophisticated recordings of Toyota Prius hybrids running on electric power and petrol-engined cars approaching at 5mph from different directions. These were played to a group of subjects wearing headphones. The subjects were asked to press one of two buttons to identify which way the vehicle was coming from as quickly and accurately as possible. As expected, they could determine the direction of the petrol-engined cars much faster. When natural background sounds, like the engine tickover of a parked car, were added, the hybrids' direction sometimes could not be detected until they were perilously close. Both sighted and blind subjects gave similar results.

Beep, beep

Dr Rosenblum and his colleagues recently repeated the experiment outside in a car park. This time blindfolded subjects stood three metres away from the point where the vehicles passed. The researchers found that the hybrid vehicles had to be around 65% closer to someone than a car with a petrol engine before the person could judge the direction correctly.

What sort of noise should electric-powered cars make? They could, perhaps, beep as some pedestrian crossings do, or buzz like a power tool. Having worked with blind subjects, Dr Rosenblum is convinced of a different answer: "People want cars to sound like cars." The sound need not be very loud; just slightly enhancing the noise of an oncoming electric vehicle would be enough to engage the auditory mechanisms that the brain uses to locate approaching sounds, he adds.

Systems to do this are already being developed. Lotus Engineering, the consultancy of a British sportscar-maker, recently signed an agreement with Harman Becker, a producer of audio systems, to commercialise one. Lotus has worked on a number of hybrid and electric vehicles and it was while these were moving around its factory that the engineers thought they would be safer if they made a noise.

The system Lotus uses was originally developed for a different reason: to cancel out intrusive noises inside a car. Sound-cancelling works by analysing any unwanted frequencies and then producing counteracting ones. The Lotus system was adapted so that it could also produce sounds that change with speed and use of the throttle, providing a familiar audible "feedback" to drivers of vehicles with a silent engine. Adding external speakers allows pedestrians to hear the noise too.

It is possible to create a different sound within a car from the one that is heard outside, says Colin Peachey, a chief engineer with Lotus. Manufacturers could create their own sounds according to how they perceive their models. Carmakers already take engine noises seriously enough to use acoustic engineers to tune exhaust pipes, especially for high-performance cars. Drivers of electric cars might in future even be able to select different engine sounds, and maybe download them like ringtones.

Although some drivers might want to cruise in an electric car thundering to the sound of a mighty V8 engine, it is not necessary—and traffic police may have something to say about it. Synthesised engine noises could even help reduce noise pollution, says Mr Peachey. For instance, sound from the speakers at the front of an electric car (or the rear if reversing) is highly directional. This means it is more likely to be noticed by pedestrians in front or behind the vehicle. The noise from an internal combustion engine, however, radiates in many directions—including upwards into offices and bedrooms.

Unique engine noises would still be possible. A sound-generator will be fitted to the Fisker Karma, a luxury plug-in electric hybrid which goes into production later this year. It will both alert pedestrians and enhance the “driver experience”, says Russell Datz of Fisker, based in California. As the Karma uses new technology it is fitting that its sound should also be new, he adds. But Fisker still has to decide what a luxury electric car should sound like.

Chinese history

The man who lost China

May 7th 2009
From The Economist print edition

History may have judged Chiang Kai-shek too severely

The Generalissimo: Chiang Kai-shek and the Struggle for Modern China
By Jay Taylor

Harvard University Press; 722 pages; $35 and £25.95

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Corbis

IN IMPERIAL China, overthrown rulers were ill-treated in the official histories written by the dynasty that succeeded them. They were blamed for all the evils that justified the transfer of the mandate of heaven. Today, not all Chinese history is written by its latest winners, the Chinese Communist Party. But its victory certainly colours views of the Republican period that preceded the revolution.

One casualty of this has been the reputation of the Republic's leader, Chiang Kai-shek. During the second world war, he was a hero in the West, feted in Cairo in 1943 by Winston Churchill and Franklin Roosevelt as the free world's great hope against Japan and the Communists in China. But, after the war, as the armies of his Kuomintang (KMT) government crumbled in the face of Mao Zedong's Communists, Chiang's standing likewise disintegrated.

The KMT was a dictatorial regime that had risen to power partly through exploiting its links with Shanghai gangsters. It was monstrously corrupt and mismanaged the economy into hyperinflation. It collapsed, largely, it seemed, under the weight of its own fecklessness and cruelty, and ended up ruling just Taiwan, from where Chiang dreamed ever more forlornly of recovering the mainland. Alliance with the dictatorship he brutally established there seemed one of those embarrassing right-wing entanglements the cold war foisted on America. Chiang himself, with his glamorous wife, Soong Mayling, his cool, austere manner and his comic-book title, “the Generalissimo”, seemed somewhere on the spectrum between joke and monster.

This enthralling book by Jay Taylor of Harvard University shows that these conventional views of both Chiang and the Chinese civil war are caricatures. It is the first biography to make full use of the Chiang family archive. This includes Chiang’s own diary, in which he wrote at least a page of classical Chinese daily from 1918 to 1972. The picture that emerges is of a far more subtle and prescient thinker than the man America’s General Joseph Stilwell used to refer to as “peanut”, and Britain’s chief of staff, Field-Marshal Lord Alanbrooke, dismissed in Cairo as “a cross between a pine marten and a ferret”.

In the 1930s Chiang soon realised that his flirtation with Italian-style fascism and a corps of Chinese “blue shirts” was a mistake, asking “how would I differ from the Communists?” He foresaw that the Japanese occupation would never be defeated until America joined the war. Personally incorruptible, Mr Taylor believes, he also understood the damage that graft did to the KMT. Indeed, he seemed to know that the better-disciplined, more fiercely motivated Communists would win one day.

Yet they need not have done. Mr Taylor recounts one of the pivotal moments in China’s civil war. This was the Xi’an incident of 1936, when Chiang was kidnapped by a warlord and pressed to form a united front with the Communists against the Japanese. Freed, Chiang had the chance of “an all-out military solution to the Communist problem”. But when an aide suggested finishing off the Communists, he “bent his head and did not answer. He had given his word.” How Mao must have laughed.

Other allies proved as fickle as Mao. In 1971, as Richard Nixon and Henry Kissinger prepared their opening to China, and consequent ditching of Taiwan, their plans reached Chiang not from Washington, DC, but from Zhou Enlai, China’s premier. Mr Taylor assumes he passed on a chilling exchange in which the author claims Mr Kissinger seemed to “tolerate a military takeover of the island by the Chinese”.

By then, however, Chiang had come to think that the loss of the mainland might have been “providential”. It had allowed him to achieve “true progress” in developing Taiwan, impossible on the mainland because of “subversion” and civil war. But Taiwan was also an unpleasantly repressive place. Its impressive strides towards democracy, which have seen the KMT both lose power and regain it, came long after his death in 1975. It was his son, Chiang Ching-kuo, who will be remembered for ushering in political reform.

Under the elder Chiang, the KMT remained what it had become in the 1920s, when, during its first united front with the Communists, it was, like them, built with Soviet advice on Leninist lines. Chiang Kai-shek’s Taiwan was in effect a one-party dictatorship presiding over a capitalist economy, pursuing hell-for-leather growth. Rather like present-day China, in fact. In this sense, Mr Taylor concludes, Chiang was not such a loser after all.

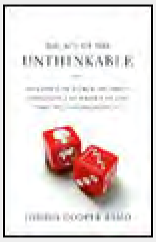
The Generalissimo: Chiang Kai-shek and the Struggle for Modern China.
By Jay Taylor.
Harvard University Press; 722 pages; $35 and £25.95

21st-century power

Future shock

May 7th 2009
From The Economist print edition

The Age of the Unthinkable: Why the New World Disorder Constantly Surprises Us and What We Can Do About It
By Joshua Cooper Ramo



Little, Brown; 279 pages; $25.99 and £20

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HIZBULLAH, the Iran-backed Shia militia in Lebanon, is one of the world's great repositories of "management secrets", writes Joshua Cooper Ramo in his new book, "The Age of the Unthinkable". Ambitious, curious and full of vigour, it is "a machine for innovation". It has learnt to parry Israeli and American might through relentless creation, for example, by inventing cheap versions of their multi-million-dollar unmanned drones. It has learnt that the best way to prosper is to interweave itself with daily life, seeing no distinction between fixing the plumbing and making bombs. "Our e-mail is flooded with CVs," boasts one senior Hizbullah figure.

Mr Ramo's book is full of engaging vignettes like this. The author, a former foreign editor of *Time* magazine who now works for Kissinger Associates, based in China, knows how to put his experience and contacts to energetic use. He introduces the reader to Shigeru Miyamoto, the salaryman behind Super Mario Brothers and the Wii. He provides a pen portrait of Aharon Farkash, a former head of Mossad who makes a powerful case for focusing on the vital few terrorist leaders (a move others call "targeted assassinations") rather than Israel's recent blunderbuss approach. The list could go on: wherever there is something interesting happening in the world, from Silicon Valley's entrepreneurial frenzy to sub-Saharan Africa's AIDS epidemic, the author seems to have talked to the most interesting people involved and thought about the most striking developments.

Mr Ramo uses his anecdotes to make some sharp observations. He points out, for example, that America's great cure-all, democratisation, can actually increase instability and stir up xenophobia, as it has in Gaza, Russia and Iran. He argues that the cost of launching a military attack has fallen dramatically while the cost of defence has risen. The September 11th 2001 hijackers spent less than $1m to attack the twin towers, whereas subsequent attempts to prevent repeat attacks have cost billions. This all but guarantees that there will be more attacks in the future.

"The Age of the Unthinkable" nevertheless delivers rather less than it promises. One reason for this is that Mr Ramo has come down with a bad case of Gladwell flu. He litters his text with experts who overturn "received wisdom". He even produces his own version of Malcolm Gladwell's "tipping point" in the form of "the sandpile" (one of his experts suggests that "after an initial period, in which the sand piled itself into a little cone, the stack would organise itself into instability, a state in which adding just a single grain of sand could trigger a large avalanche…").

The biggest problem is that Mr Ramo's thesis is neither as striking nor as convincing as he seems to think. The 21st century has seen so many examples of "the unthinkable", from the twin-tower attacks to the recent financial meltdown, that the unthinkable is now routine and thus thinkable. Meanwhile, scepticism about experts is institutionalised. Blaming economists for failing to spot the worst recession since the 1930s is the norm, not the exception.

And is this era really the first unpredictable one? The "death of distance" is speeding up the rate of change while "disruptive" innovation is sending that change in all sorts of directions. But unpredictability is hardly unique to the first decade of this century. One of the biggest selling books in Edwardian England, "The Great Illusion" by Norman Angell, argued that, thanks to the growing integration of the global economy, war was going out of fashion. In the 1980s the CIA was still predicting that the Soviet Union was going from strength to strength. Indeed, over the centuries futurologists have more often been wrong than right. "The Age of the Unthinkable" is a thought-provoking book. Unfortunately, one of the thoughts that it provokes is that its central argument is wrong.

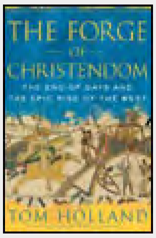
The Age of the Unthinkable: Why the New World Disorder Constantly Surprises Us and What We Can Do About It.
By Joshua Cooper Ramo.
Little, Brown; 279 pages; $25.99 and £20

The rise of Christianity

The millennium bug

May 7th 2009
From The Economist print edition

The Forge of Christendom: The End of Days and the Epic Rise of the West
By Tom Holland



Doubleday; 476 pages; $30

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IN THE final months of the second Christian millennium there was a belief in parts of south-eastern Europe that an apocalyptic war was about to break out. It was especially strong among devout Orthodox Christians in Greece. Apart from the onset of the year 2000, the mood was stimulated by real political events and it had real consequences.

As NATO dropped its bombs over Serbia, there was a genuine risk that conflict might engulf the Balkans and possibly Russia. Meanwhile Turkey's security chiefs were muttering darkly about punishing Greece for abetting Kurdish terrorists. In this anxious climate, many Greeks warmed to the fiery rhetoric of an Archbishop of Athens who denounced his country's government for (very cautiously) curbing the power of the Church. The rise of religious-nationalist sentiment in Greece and elsewhere exacerbated an already high level of regional tension and created a danger that apocalyptic talk could become self-fulfilling.

Something similar happened all over Europe and the Middle East around the turn of the first Christian millennium. That is the central theme of an enjoyable and exuberantly argued book by a British historian, Tom Holland, who combines sound scholarly credentials with a gift for storytelling on a magisterial scale. To cut a long and complex tale short, he suggests that the 1,000-year landmark in the Christian calendar (whose effect was felt throughout the following century) helped to stimulate a mood of impending apocalypse, and a tendency to interpret troubling geopolitical events, such as victories by the Berbers in Spain or the Turks in Anatolia, in apocalyptic terms.

This mood created a favourable background for zealous forms of religion—the sort of religion that thrives when people see little virtue in marrying, breeding or building up private property. That in turn made it easier for clerical power to trump the worldly kind. Having extended their influence at the expense of purely earthly powers, the theocrats had an interest in keeping geopolitical tension on the boil.

Although Mr Holland's narrative ranges in a spectacular way from Greenland to Baghdad, taking in Córdoba and Sicily, one defining moment (in a story that might also have been called "The Uses of Apocalypse") occurs in 1077, at Canossa in northern Italy. At that point, the "Holy Roman" emperor, Henry IV, gives ground in a bitter power struggle with the papacy, begs the pope's forgiveness and is readmitted to the good graces of the church. There were several more bloody rounds in the contest between empire (what Mr Holland teasingly calls "the Reich") and the Holy See. But the papal success at Canossa paved the way for an even more spectacular assertion of clerical power. This was the proclamation of the first crusade, an enterprise calculated to unite Christians in the present-day lands of France, Germany and Italy, and far beyond.

Despite the "silence of the poor" in the written records of this period, which Mr Holland acknowledges, the consolidation of clerical power was almost certainly assisted by a public mood that admired ascetic and genuinely celibate monastics and bishops, and loathed those who merely feigned such qualities.

Mr Holland doesn't quite prove that millenarian angst was a decisive factor in the history of Europe and the Mediterranean. The military successes of the "barbarians" (who were themselves completely indifferent to the Christian system of computing dates) would have been terrifying in any year. What he does demonstrate, in a tightly woven and sometimes witty narrative, is the subtle interplay of genuine religious sentiment and cynical power politics. Christians, from beggars to princes, believed passionately in the saving power of sacraments, which only the church could administer, and in the sanctity of the holy sepulchre. The use that was made of these beliefs by the powerful (whether that power was secular or clerical) can often look cynical to a modern observer. Yet as this book will make clear, even to the

most hard-boiled of readers, such tricks would not have worked without an intensity of belief that is difficult to imagine today. Or difficult to imagine before the lesson of September 11th 2001.

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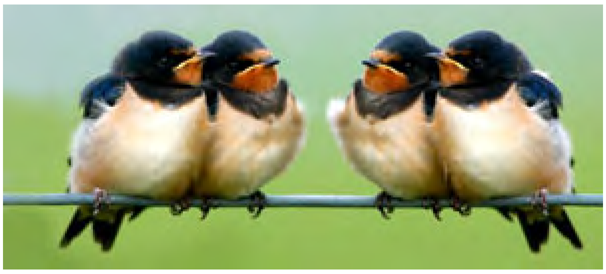
By Tom Holland.
Doubleday; 476 pages; $30

Migrating swallows

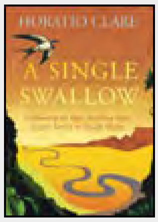
Spring bringers

May 7th 2009
From The Economist print edition

Alamy



A Single Swallow: Following an Epic Journey from South Africa to South Wales
By Horatio Clare



Chatto and Windus; 327 pages; £17.99

Buy it at Amazon.co.uk

SIXTEEN million migratory birds fly to Britain every year from sub-Saharan Africa in a flurry of wing beats that herald the spring. Of the 50 species that make the journey, the best loved are swallows.

Known by an array of magical names—*golodrina* in Spain, the bird that thaws the snow; *svala* in Sweden, to console; and in Africa *inkonjani*, the lightning bird, *nyankalema*, the bird that never gets tired, or *giri giri*, a magical charm—swallows have lived alongside humans for thousands of years. The Minoans painted them on the walls of their houses in 1600BC. Their images decorated Greek vases a thousand years later and they are mentioned in the poetry of Virgil and Ovid. The Austrians believe swallows built the sky and myth says they pulled the thorns from the head of Christ: how else did they get their blood-red cheeks?

In his latest book, which is not so much a work about swallows as an African travel adventure built around them, Horatio Clare sets out to follow the migration route of the barn swallow (*Hirundo rustica*) from the reed beds of Bloemfontein in South Africa to the eaves of his family's barn in south Wales. Mr Clare, who portrayed his unconventional upbringing on a Welsh hill farm in an earlier memoir, “Running for the Hills”, sees his journey as a way of separating “the boy-man I was from the man I wanted to become”.

Travelling by any means he can find, he crosses nine African countries, meeting along the way the power-crazy, the kind, the mad and the desperate. Although his tight schedule means he rather pelts through the continent, his eye for detail and his elegant pen give a flavour of each country he crosses: great veldts and high plateaux, Congo's “green vastness”, the “sandy seas” of the Sahel and, finally, the fertile plain of the north African coast.

Swooping exuberantly above him are the swallows, skimming over rooftops, across rivers and valleys, blue backs glistening, forked tails dancing behind them as they curve trajectories in the sky, a graceful reminder of the inspirational and unending power of nature.

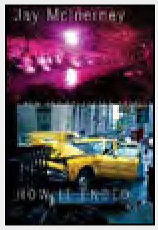
A Single Swallow: Following an Epic Journey from South Africa to South Wales.
By Horatio Clare.
Chatto and Windus; 327 pages; £17.99

New fiction

Living daylights

May 7th 2009
From The Economist print edition

How It Ended: New and Collected Stories
By Jay McInerney



Knopf; 352 pages; $25.95

Buy it at
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JAY MCINERNEY'S debut novel, "Bright Lights, Big City", was a sensation when it came out in 1984. A wickedly funny account of a nightlife- and cocaine-addicted fact-checker at a *New Yorker*-like magazine—written famously in the second person—the novel simultaneously critiqued and celebrated the 1980s culture of excess. It turned its author into a literary star. The young, brash Mr McInerney gained a notorious reputation in gossip pages and glossy magazines for his own hard-partying habits, his reported drug use and dramatic private life. His second wife attempted suicide after he left her for a fashion model. It was a meteoric rise that the author later came to regret, telling the *Observer* in 2000 that his early success "unsettled my life in a way that I only now realise".

Twenty-five years later Mr McInerney is still best known for "Bright Lights, Big City". Such are the perils of a blockbuster debut. And yet he has continued to write, producing six more novels, two volumes of essays on wine and a bevy of journalism. His work, by and large, has remained preoccupied with the manners and habits of striving, privileged New Yorkers—bankers, lawyers, publishers, writers and magazine editors—treating them with a combination of knowing satire and romantic enthusiasm.

In the early 1980s, Mr McInerney studied at Syracuse University with two legendary short-story writers, Raymond Carver and Tobias Wolff, an education he recalls fondly in the preface to his new, career-spanning volume, "How It Ended". Though he claims many of his own stories have served as "warm-up exercises" for his novels, the best of them here stand strongly on their own. A restless energy characterises the earliest work, especially "It's Six A.M. Do You Know Where You Are?", Mr McInerney's first published story which ran in *The Paris Review* in 1982 and later became the opening chapter of "Bright Lights, Big City". Here the reader is treated to his knack for opening lines ("You are not the kind of guy who would be at a place like this at this time of the morning") and his talent for bluntly evocative metaphor. The sensation of lying in bed ramped up on cocaine is "a desperate half-sleep—like a grease fire in the brain pan."

Mr McInerney proudly dates himself in his work, naming songs he heard in clubs, the fashion labels worn by his characters, the television shows and films of the moment. In a hauntingly sad story, "Smoke", from 1985 and one of the strongest in the collection, a book editor named Russell Callahan thinks he has found a mistress to serve as a popcorn substitute for his sophisticated wife Corrine. The assessment is pure McInerney: "If Nancy were a film, she'd be 'Superman II'. Corrine was, say, 'Hiroshima Mon Amour'."

Mr McInerney's sense of humour and his keen social awareness never fail him. Alas, though, there is a nagging insubstantiality to the most recent stories. Ten of them, he writes, were "composed in something of a sprint from December 2007 through the late spring of 2008". "Sleeping With Pigs" and "Penelope on the Pond" certainly have a hurried feel. Occasionally the language slackens into cliché: "we were finally addressing the elephant in the room"; "I could get into a sticky situation"; "I hadn't quite passed the sniff test". And the too-pat endings often leave the impression of chapters from novels-in-progress rather than fully formed stories.

Still, "How It Ended" carries the reader along, providing an incisive view of New York's moneyed elite. Mr McInerney's fiction does not address how this group has been chastened by recent events, but his concluding story, "The Last Bachelor", has a timely, valedictory air. A hard-partying playboy has been spoiled by years of carousing. Now, he is trying, and failing, to settle down. There is a suggestion of autobiography here, and yet the story also satisfies on another level: as a resonant portrait of an unsettled moment.

How It Ended: New and Collected Stories.
By Jay McInerney.
Knopf; 352 pages; $25.95

Contemporary jewellery

Golden globes

May 7th 2009 | AMSTERDAM
From The Economist print edition

Contemporary jewellery is more about ideas than the flaunting of wealth

Galerie Marzee

THROUGH the centuries people have worn jewellery to depict status, wealth and identity. Now there is another reason. Contemporary jewellery, the kind that is fought over by passionate collectors, focuses as much on intellectual inquiry and the telling of stories as it does on the exploration of materials and techniques.

To the cognoscenti, contemporary jewellery is wearable sculpture, and the wearability of a piece and the way it moves on the body are of critical importance to the artists who create it. This work is a product of head, heart and hand, with the head element uppermost. Pieces can be made of anything: found objects, recycled junk, textiles, plastic—even paper. If they include precious metals and gemstones, these rarely appear in conventional forms. Collectors are mainly professionals. A significant proportion are architects and many of them are men.

Humour and subversion are an intrinsic element of this kind of jewellery, which may explain why one European country, the Netherlands, has become a beacon for collectors. As Marjan Unger, a Dutch art historian and jewellery curator, explains it, the Dutch “like to turn things upside down”. They possess a fierce merchant mentality, but do not like to display their wealth, preferring instead to show off their intellectual power. Dutch baby-boomers have (until recently) enjoyed ever higher incomes, while retaining their taste for protesting and being experimental.

The Netherlands boasts some fine jewellery schools, but, other than diamond-cutting, there is little historical tradition in jewellery making. Dutch designers have not had to fight entrenched conventions, and as a result they have been remarkably free to experiment.

“Collect”, an international fair for contemporary objects, which opens in London later this month, will show a number of artists who explore concepts of preciousness, value and beauty by subverting traditional materials and techniques. Some are German, Swiss and British, as well as Dutch. Otto Künzli famously made a rubber bracelet concealing a gold ball inside. Karl Fritsch ground gemstones into powder and reassembled them with glue. He is now experimenting with drilling holes in the gems and knotting them together in varying configurations. Gijs Bakker, co-founder of Droog, a design company, combines gemstones with costume pieces. Ulrich Reithofer combines gold and glass shards in a necklace (pictured below).

Using unconventional materials is another way of questioning “value”. Dorothea Prühl uses wood to create huge neckpieces. Christoph Zellweger covers animal bones with flesh-coloured flock. Lisa Walker assembles three-dimensional collages using found plastic pieces and turns them into wearable sculpture. Sebastian Buescher pins together eclectic combinations of materials he gathers outdoors.

Storytelling is another key element. The narratives vary from the personal to the collective, but individual

memories are often used to tap into universal themes. The domestic is a favourite. Gesine Hackenberg drills out circles from discarded plates, configuring them into necklaces which she presents on the original, now disfigured, platters. Iris Eichenberg examines the psychological effect of transition to a new culture by assembling materials from different elements of an interior such as flooring, wall coverings and furniture into brooches and neck pieces. Francis Willemstijn even uses old car parts to allude to her childhood spent in her father's garage; contrary to expectation, they make exquisite jewellery.

This is jewellery offering a very different expression of identity. The wearer of such pieces challenges preconceived notions. It can include a whiff of intellectual snobbery, as the wearer can be seen as "buying a bit of the artist's brain".

The Netherlands boasts the largest concentration of serious contemporary-jewellery galleries in the world. Many of those that set the standard, including Ra, Marzee, Louise Smit and Rob Koudijs, will show at "Collect". Marzee in Nijmegen, an hour outside Amsterdam, is a four-storey converted grain warehouse with a double-height glass atrium which would be the envy of any fine-art gallery. Indeed, Marzee sees its jewellery as art that can be worn. Solo shows are accompanied by catalogues and supported by displays from other artists. It is like a small museum, with the owner's 1,000-piece personal collection on display. The gallery owners see their role as educational as well as commercial. When they started, contemporary jewellery was an unknown field and they had a missionary zeal to educate their clients. As Paul Derrez, founder of Ra, says: "Our clients don't come to find what they already know, they come to be excited about things they don't know."

"Collect" is at the Saatchi Gallery, London, from May 15th until May 17th

Hans Holzer

May 7th 2009
From The Economist print edition

Hans Holzer, ghost hunter, died on April 26th, aged 89

James J. Kriegsmann

AS FAR as Hans Holzer was concerned, his Uncle Henry had started it. Uncle Henry, despite his humdrum life as a Viennese shop assistant, was a very strange man, who could feel “imprints” from the past in his 18th-century bed, and who taught his young nephew to say good morning to the fairies in the trees. After he had passed over he did his damnedest, via a British medium, to keep in touch with Hans, who had emigrated to New York. This ran up a fortune in transatlantic telephone bills. “Tell him the dog’s name was Rigo,” cried Uncle Henry, faintly and through static from the Other Side, when he thought his bona fides were doubted.

At four, Hans found himself pretending to read ghost stories in nursery class to a circle of terrified small friends. At 43, with a doctorate in parapsychology (so he said) and dozens of investigations under his belt, he produced “Ghost Hunter”, the first of around 140 books on haunted houses, “beings of light”, extrasensory perception and hair-raising subjects generally. American television snapped him up. His calm, intense look, his deliberate walk and his soft Austrian accent were somehow both scary and reassuring, just right for footage of night windows banging and curtains inexplicably blowing.

Mr Holzer was keen to tell Americans that ghosts were nothing to be frightened of. Though proud to be the country’s premier ghost hunter, a term he had coined himself, he preferred to be called “Doctor” or, better still, “Professor”, and thought of as a scientist. He dealt only in facts, he said, elicited from witnesses whom he interviewed repeatedly to be sure they were not crazy. It was not a matter of belief or disbelief, but of hard evidence, even if it had a shimmery and ectoplasmic look.

Burying Aunt Minnie

Ghosts, he explained, were perfectly natural. They were simply human beings who were not aware they were dead. They had shed their outer bodies but not their more sensitive inner ones, in which they walked about much as before. They were either in emotional turmoil, trapped between the worlds of “here” and “there” and throwing vases to get attention, or they were placid “stay-behinds”, who had died so peacefully that they never bothered to leave the place they knew. That explained, said Mr Holzer, how a grieving family could bury Aunt Minnie at midday, and find her still sitting in her chair at three o’clock.

He seldom saw ghosts himself, though in his 40s he felt his shining, nightgowned mother push his head back on the pillow to save him from a migraine. But he found that a high-speed Polaroid camera could catch them, and that skilled mediums, sometimes young women trained by himself on his own "doctor's" couch (for ghosts were not all he chased), could channel their conversations. This was the only equipment he took to haunted houses. There, making himself comfortable, he would ask the ghost to explain his or her problems and then encourage it to leave for the spirit world. "She's free to go," he instructed his medium to tell Margaret Hatton, a young woman from 1843 still trapped in a house in Port Clyde, Maine, where she was worrying about tallow for the lamps and the empty root cellar. "To Kennebunk?" came the ghost's eager response.

His most famous investigation was not his most successful. In January 1977, in company with Ethel Johnson Meyers, he went round 112 Ocean Avenue in Amityville, Long Island. The house, cold, empty and boarded up, was a wooden Dutch Colonial at the edge of the water. Three years before a young man had murdered his parents and siblings, one by one, in their beds. Since then, sounds of doors slamming and bands playing had been heard there. Swarms of flies infested the place. Green slime oozed from the hall walls, crucifixes rotated and a child with red glowing eyes was seen at the top of the stairs. Mr Holzer, ever the scientist, dismissed most of that. The solution to the "Amityville Horror", as Hollywood soon called it, was simple demonic possession by an Indian chief, who was channelled by Ms Meyers. Hollywood, with whom Mr Holzer had rather tense relations, promptly made a sequel, "Amityville II: The Possession". The Amityville Historical Society, however, could not find any link between the house and Indians, annoyed or otherwise.

Mr Holzer never knew whether his attempts to nudge ghosts to the Other Side (another of his coinings) were successful, or not. He did not make it sound particularly enticing. No angels, he said confidently, and no "fellows in red underwear with pitchforks" either. Disappointingly, the whole place was much like here, but with no sense of time and with everything "strung out further" in the thinner atmosphere. Even more disappointingly, it was run by a giant and orderly bureaucracy, in which spirits had to ask permission and list their motives if they wished to contact mediums and had to stand in line, waiting for a clerk to find suitable parents, in order to be born again. "They" used the word "clerk", he said. And "they" had also instructed him to tell the world the truth about ghosts. They would be irritated if he failed, and would put him down for further education.

No funeral arrangements were announced for Mr Holzer. He did not intend, however, to stick around.

Overview

May 7th 2009
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In **America** the Institute for Supply Management's index of non-manufacturing businesses rose from 40.8 in March to 43.7 last month. And in **Britain** the Chartered Institute of Purchasing and Supply's index for services hit 48.7 in April compared with 45.5 a month earlier. In both cases a reading below 50 points to shrinking activity, hence the rise in the indices means only that the pace of decline is slowing.

Orders received by **American** factories declined by 0.9% in March, after rising by 0.7% in February.

Industrial production in **Brazil** rose for the third month in a row in March. But the 0.7% month-on-month increase was slower than the 2.1% increase in January and February's 1.9% rise, and far from enough to erase last year's steep falls: industrial output in March was 10% lower than a year earlier.

South Africa's unemployment rate increased to 23.5% in the first three months of the year from an already high 21.9% in the last quarter of 2008. Between the two quarters 208,000 jobs were lost, 88,000 of them in the formal economy. But total employment was still 0.1% higher than a year ago.

Russia's inflation rate declined to 13.2% in April, from 14% the previous month. Food prices rose by 0.7% last month, compared with a 1.7% increase in March.

Norway's central bank cut its benchmark interest rate by half a percentage point, to 1.5%, a record low.

Output, prices and jobs

May 7th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2009†	2010†	latest	latest	year ago	2009†	rate‡, %
United States	−2.6 Q1	−6.1	−2.9	+1.4	−12.8 Mar	−0.4 Mar	+4.0	−0.8	8.5 Mar
Japan	−4.3 Q4	−12.1	−6.4	+0.6	−34.2 Mar	−0.3 Mar	+1.2	−1.1	4.8 Mar
China	+6.1 Q1	na	+6.5	+7.3	+8.3 Mar	−1.2 Mar	+8.3	−0.5	9.0 2008
Britain	−4.1 Q1	−7.4	−3.7	+0.3	−12.5 Feb	+2.9 Mar§	+2.5	+1.5	6.7 Feb††
Canada	−0.7 Q4	−3.4	−2.3	+1.6	−7.6 Feb	+1.2 Mar	+1.4	+0.5	8.0 Mar
Euro area	−1.5 Q4	−6.2	−3.7	+0.3	−18.4 Feb	+0.6 Apr	+3.3	+0.4	8.9 Mar
Austria	+0.5 Q4	−0.8	−2.1	+0.2	−14.2 Feb	+0.8 Mar	+3.5	+0.6	4.5 Mar
Belgium	−3.0 Q1	−6.2	−3.0	+0.2	−18.6 Feb	+0.6 Apr	+4.2	+0.6	11.2 Feb‡‡
France	−1.1 Q4	−4.4	−2.9	+0.3	−15.5 Feb	+0.3 Mar	+3.2	+0.2	8.8 Mar
Germany	−1.7 Q4	−8.2	−5.2	+0.3	−20.3 Feb	+0.7 Apr	+2.4	+0.2	8.1 Mar
Greece	+2.4 Q4	+1.2	−3.6	−1.1	−4.6 Feb	+1.3 Mar	+4.4	+0.9	9.4 Jan
Italy	−2.9 Q4	−7.5	−4.0	+0.1	−20.7 Feb	+1.3 Apr	+3.3	+0.7	6.9 Q4
Netherlands	−0.6 Q4	−3.8	−3.1	+0.5	−12.7 Feb	+2.0 Mar	+2.2	+0.9	4.1 Mar††
Spain	−0.7 Q4	−3.8	−3.3	−0.5	−24.7 Mar	−0.1 Mar	+4.5	−0.1	17.4 Mar
Czech Republic	+0.7 Q4	−3.7	−3.0	+1.2	−17.5 Mar	+2.3 Mar	+7.1	+1.8	7.7 Mar
Denmark	−3.7 Q4	−7.3	−3.1	+0.6	−15.0 Mar†††	+1.8 Mar	+3.1	+1.2	2.9 Mar
Hungary	+2.0 Q4	−3.9	−6.0	−1.0	−19.6 Mar	+2.9 Mar	+6.7	+2.8	9.7 Mar††
Norway	+0.8 Q4	+5.6	−2.0	+0.5	−5.1 Feb	+2.5 Mar	+3.2	+1.9	3.1 Feb***
Poland	+2.9 Q4	na	−0.4	+1.8	−14.3 Feb	+3.6 Mar	+4.1	+3.0	11.2 Mar‡‡
Russia	+1.2 Q4	na	−3.0	+2.0	−13.7 Mar	+13.2 Apr	+14.3	+13.8	10.0 Mar‡‡
Sweden	−4.9 Q4	−9.3	−4.1	+0.8	−22.9 Mar	+0.2 Mar	+3.4	−0.2	8.3 Mar‡‡
Switzerland	−0.1 Q4	−1.2	−2.4	+0.2	−6.0 Q4	−0.3 Apr	+2.3	−0.5	3.3 Mar
Turkey	−6.2 Q4	na	−4.4	+1.0	−23.7 Feb	+6.1 Apr	+9.7	+6.8	12.3 Q4‡‡
Australia	+0.3 Q4	−2.1	−0.7	+1.6	−0.7 Q4	+2.5 Q1	+4.2	+2.0	5.4 Apr
Hong Kong	−2.5 Q4	−7.8	+5.4	+5.3	−10.3 Q4	+1.2 Mar	+4.1	+3.3	5.2 Mar††
India	+5.3 Q4	na	+5.0	+6.4	−1.2 Feb	+9.6 Feb	+5.5	+5.0	6.8 2008
Indonesia	+5.2 Q4	na	−1.4	+0.5	−2.4 Feb	+7.3 Apr	+6.8	+4.2	8.4 Aug
Malaysia	+0.1 Q4	na	−3.0	+1.1	−14.6 Feb	+3.5 Mar	+2.8	−0.7	3.0 Q4
Pakistan	+5.8 2008**	na	+0.6	+3.2	−8.9 Jan	+19.1 Mar	+14.1	+9.9	5.6 2007
Singapore	−11.5 Q1	−19.7	−8.8	+0.9	−33.9 Mar	+1.6 Mar	+6.7	+0.1	3.2 Q1
South Korea	−4.3 Q1	+0.2	−5.9	+0.3	−10.6 Mar	+3.6 Apr	+4.1	+0.1	3.7 Mar
Taiwan	−8.4 Q4	na	−9.3	+0.1	−26.0 Mar	−0.5 Apr	+3.9	−1.6	5.7 Mar
Thailand	−4.3 Q4	−22.2	−4.4	+1.4	−15.4 Mar	−0.9 Apr	+6.2	−1.2	2.4 Jan
Argentina	+4.9 Q4	−1.2	−3.0	+1.5	−0.9 Mar	+6.3 Mar	+8.8	+6.2	7.3 Q4‡‡
Brazil	+1.3 Q4	−13.6	−1.5	+2.7	−10.0 Mar	+5.6 Mar	+4.7	+4.4	9.0 Mar‡‡
Chile	+0.2 Q4	−8.3	−0.5	+2.4	−7.1 Mar	+5.0 Mar	+8.5	+3.0	9.2 Mar††‡‡
Colombia	−0.7 Q4	−4.1	−3.0	+1.5	−12.8 Feb	+6.1 Mar	+5.9	+5.4	12.5 Feb‡‡
Mexico	−1.6 Q4	−10.3	+3.4	+3.4	−13.2 Feb	+6.0 Mar	+4.3	+3.6	4.8 Mar‡‡
Venezuela	+3.2 Q4	na	−5.0	−5.4	−0.9 Jan	+29.4 Apr	+29.3	+30.3	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+3.6	+3.7	+7.3 Q3	+12.1 Mar	+14.4	+9.1	9.4 Q1‡‡
Israel	+1.2 Q4	−0.5	−0.8	+2.0	−1.7 Feb	+3.6 Mar	+3.7	+0.7	6.3 Q4
Saudi Arabia	+4.2 2008	na	−1.0	+3.3	na	+6.0 Mar	+8.3	+4.3	na
South Africa	+1.0 Q4	−1.8	−1.8	+3.1	+8.6 Feb	+8.5 Mar	+10.6	+6.0	23.5 Mar‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	−9.7 Q4	na	−10.0	−2.5	−29.7 Mar	+2.0 Mar	+10.9	+0.5	9.9 Feb
Finland	−2.4 Q4	−5.0	−5.1	−1.3	−22.8 Feb	+0.9 Mar	+3.9	+0.7	7.6 Mar
Iceland	−1.3 Q4	−3.6	−12.4	−0.9	+0.4 2007	+11.9 Apr	+11.8	+12.5	8.9 Mar‡‡
Ireland	−7.5 Q4	−25.7	−7.3	−2.6	−1.7 Feb	−2.6 Mar	+5.0	−3.5	11.4 Apr
Latvia	−10.3 Q4	na	−15.0	−4.0	−23.4 Mar	+8.2 Mar	+16.7	+2.5	12.3 Jan
Lithuania	−12.6 Q1	−32.9	−10.0	−2.5	na	+7.6 Mar	+11.2	+4.5	9.5 Mar‡‡
Luxembourg	−5.2 Q4	−16.8	−4.0	−0.5	−24.1 Dec	+0.3 Mar	+3.5	+0.5	5.5 Mar‡‡
New Zealand	−2.3 Q4	−2.3	−3.2	+0.7	−0.5 Q3	+3.0 Q1	+3.4	+1.6	5.0 Q1
Peru	+0.2 Feb	na	+2.8	+3.9	−7.4 Feb	+4.6 Apr	+5.5	+4.7	9.4 Feb‡‡
Philippines	+4.5 Q4	+4.1	−1.9	+1.4	−21.1 Feb	+4.8 Apr	+8.3	+1.9	7.7 Q1‡‡
Portugal	−1.8 Q4	−6.2	−4.2	−0.5	−13.7 Feb	−0.4 Mar	+3.1	−1.0	7.8 Q4††
Slovakia	+2.5 Q4	na	−2.0	+1.0	−27.4 Feb	+2.6 Mar	+4.2	+2.0	10.3 Mar‡‡
Slovenia	−0.8 Q4	na	−3.0	+1.1	−22.3 Feb	+1.1 Apr	+6.5	+1.1	8.2 Feb‡‡
Ukraine	+6.9 Q3	na	−6.0	+2.0	−30.4 Mar	+18.1 Mar	+26.2	+16.6	3.1 Mar
Vietnam	+5.5 Q4	na	+1.6	+2.0	+2.4 Mar	+11.2 Mar	+19.4	+4.8	4.6 2007

*% change on previous quarter, annual rate. †The Economist poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate -0.4 in Mar. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

May 7th 2009
From The Economist print edition

The Economist commodity-price index

2000=100

	Apr 28th	May 5th*	% change on one month	% change on one year
Dollar index				
All items	164.9	176.1	+5.8	-31.0
Food	188.1	199.8	+5.3	-20.6
Industrials				
All	134.9	145.6	+6.6	-44.0
Nfa†	120.0	126.1	+4.7	-34.7
Metals	143.0	156.3	+7.6	-47.4
Sterling index				
All items	170.6	177.2	+3.5	-9.5
Euro index				
All items	116.6	122.0	+5.1	-19.6
Gold				
$ per oz	890.10	904.30	+2.7	+2.8
West Texas Intermediate				
$ per barrel	49.08	53.81	+9.7	-55.8

*Provisional †Non-food agriculturals.

The Economist poll of forecasters, May averages

May 7th 2009
From The Economist print edition

***The Economist* poll of forecasters, May averages** (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2009	2010	2009	2010	2009	2010	2009	2010
Australia	-1.6/0.1	0.3/3.1	-0.7 (-0.8)	1.6	2.0 (2.1)	2.4 (2.3)	-5.0 (-5.2)	-5.6 (-5.7)
Belgium	-4.2/-1.5	-1.0/1.2	-3.0 (-2.7)	0.2 (0.3)	0.6 (0.7)	1.4 (1.5)	-1.8 (-1.4)	-1.7 (-1.6)
Britain	-4.4/-2.5	-1.1/1.9	-3.7 (-3.5)	0.3	1.5 (1.2)	1.8 (1.7)	-1.7	-1.3 (-1.2)
Canada	-3.0/-1.8	0.8/2.5	-2.3 (-1.9)	1.6	0.5 (0.6)	1.7 (1.5)	-2.0	-1.1 (-1.2)
France	-3.5/-2.2	-0.6/1.1	-2.9 (-2.7)	0.3	0.2 (0.3)	1.1 (1.2)	-2.3 (-2.2)	-2.6 (-2.5)
Germany	-5.9/-4.0	-0.8/1.3	-5.2 (-4.3)	0.3	0.2 (0.3)	0.8 (0.9)	4.4 (4.5)	4.1 (4.3)
Italy	-5.2/-3.0	-0.9/0.7	-4.0 (-3.7)	0.1	0.7 (0.8)	1.4	-2.6	-2.6 (-2.5)
Japan	-8.0/-5.3	-0.8/2.3	-6.4 (-6.5)	0.6 (0.4)	-1.1 (-1.0)	-0.4 (-0.3)	1.6 (1.5)	1.8 (1.6)
Netherlands	-4.1/-2.1	-0.9/1.3	-3.1 (-2.7)	0.5	0.9	0.9 (1.0)	5.9	4.6 (5.3)
Spain	-4.0/-1.8	-1.9/0.7	-3.3 (-3.1)	-0.5	-0.1 (0.3)	1.4	-6.9 (-7.5)	-6.7
Sweden	-5.3/-3.3	-0.3/2.0	-4.1 (-3.6)	0.8 (0.7)	-0.2 (-0.1)	1.1 (1.0)	7.1 (7.3)	7.2 (7.3)
Switzerland	-3.7/-1.5	-1.5/1.0	-2.4 (-2.3)	0.2 (0.1)	-0.5 (-0.2)	0.5 (0.6)	7.5	7.6 (7.5)
United States	-3.9/-1.6	-0.2/2.7	-2.9 (-2.7)	1.4	-0.8	1.2	-3.3	-3.4
Euro area	-4.3/-3.1	-0.7/1.1	-3.7 (-3.4)	0.3 (0.2)	0.4	1.0 (1.1)	-1.0	-0.8 (-0.9)

Sources: BNP Paribas, Citigroup, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, RBS, Scotiabank, UBS

Trade, exchange rates, budget balances and interest rates

May 7th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2009†	Currency units, per $ May 6th	Currency units, per $ year ago	Budget balance % of GDP 2009†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	-761.0 Feb	-673.3 Q4	-3.3	-	-	-13.1	0.27	3.15
Japan	+21.0 Feb	+131.8 Feb	+1.6	98.7	105	-6.3	0.50	1.39
China	+316.9 Mar	+400.7 Q2	+6.9	6.82	6.99	-3.5	1.21	3.43
Britain	-163.1 Feb	-44.6 Q4	-1.7	0.66	0.51	-12.3	1.40	3.59
Canada	+37.1 Feb	+11.3 Q4	-2.0	1.18	1.00	-2.5	0.18	3.24
Euro area	-59.4 Feb	-150.9 Feb	-1.0	0.75	0.65	-5.7	1.33	3.24
Austria	-3.9 Feb	+15.0 Q4	+1.7	0.75	0.65	-4.6	1.33	3.97
Belgium	+8.2 Jan	-12.1 Dec	-1.8	0.75	0.65	-4.7	1.35	3.87
France	-79.1 Mar	-54.4 Feb	-2.3	0.75	0.65	-6.6	1.33	3.63
Germany	+234.6 Feb	+206.2 Feb	+4.4	0.75	0.65	-4.4	1.33	3.24
Greece	-63.2 Jan	-48.7 Feb	-12.8	0.75	0.65	-5.0	1.33	5.22
Italy	-15.7 Feb	-72.9 Feb	-2.6	0.75	0.65	-5.3	1.33	4.19
Netherlands	+50.2 Feb	+65.3 Q4	+5.9	0.75	0.65	0.2	1.33	3.68
Spain	-127.3 Feb	-144.9 Feb	-6.9	0.75	0.65	-9.6	1.33	3.92
Czech Republic	+3.5 Feb	-7.2 Feb	-2.2	20.1	16.3	-3.6	2.52	5.43
Denmark	+6.0 Feb	+6.4 Feb	+1.0	5.60	4.85	-2.5	2.85	3.66
Hungary	+0.1 Mar	-13.0 Q4	-3.0	214	164	-2.9	9.69	10.35
Norway	+70.5 Mar	+83.4 Q4	+10.5	6.53	5.12	10.5	2.58	3.95
Poland	-22.2 Feb	-25.5 Feb	-5.1	3.31	2.22	-3.2	4.42	6.24
Russia	+151.6 Mar	+75.4 Q1	-1.1	32.8	23.8	-8.0	12.50	10.94
Sweden	+13.7 Mar	+40.3 Q4	+7.1	7.93	6.04	-4.7	0.33	3.40
Switzerland	+16.9 Mar	+53.3 Q4	+7.5	1.13	1.06	-2.0	0.41	2.17
Turkey	-58.1 Mar	-33.1 Feb	-1.3	1.57	1.25	-4.4	10.45	7.09‡
Australia	+5.2 Mar	-44.1 Q4	-5.0	1.34	1.06	-3.3	3.14	4.78
Hong Kong	-23.8 Mar	+30.6 Q4	+5.3	7.75	7.80	2.4	0.72	2.00
India	-109.0 Mar	-37.5 Q4	-3.0	49.6	41.4	-7.7	3.31	7.45
Indonesia	+7.3 Mar	+0.6 Q4	-0.3	10,410	9,225	-2.9	8.42	7.59‡
Malaysia	+42.1 Feb	+39.1 Q4	+10.2	3.53	3.17	-8.7	2.09	3.03‡
Pakistan	-18.7 Mar	-15.3 Q4	-1.3	80.5	67.1	-6.4	13.24	17.81†
Singapore	+16.3 Mar	+27.1 Q4	+17.2	1.47	1.37	-4.1	0.56	2.01
South Korea	+3.3 Apr	+7.4 Mar	+1.9	1,277	1,026	-6.5	2.41	4.81
Taiwan	+9.8 Mar	+25.0 Q4	+11.1	33.2	30.5	-5.3	0.85	1.49
Thailand	+7.8 Mar	+5.9 Mar	+2.0	35.2	31.8	-4.7	1.45	2.57
Argentina	+13.6 Mar	+7.6 Q4	+1.1	3.70	3.18	-0.8	14.38	na
Brazil	+27.0 Apr	-23.0 Mar	-1.2	2.12	1.67	-2.0	10.16	6.16‡
Chile	+4.6 Mar	-3.4 Q4	-3.8	573	468	-3.4	2.28	3.38‡
Colombia	+2.1 Feb	-6.8 Q4	-4.0	2,230	1,788	-3.3	7.09	6.00‡
Mexico	-17.2 Mar	-2.4 Q4	-1.5	13.2	10.5	-5.3	5.54	7.45
Venezuela	+39.2 Q4	+39.2 Q4	+0.4	6.64	3.38§	-5.3	16.00	6.55‡
Egypt	-26.8 Q4	-1.3 Q4	-0.8	5.63	5.36	-6.9	10.41	3.52‡
Israel	-12.0 Mar	+1.6 Q4	+2.0	4.15	3.46	-5.9	0.38	3.83
Saudi Arabia	+197.4 2008	+124.0 2008	-8.4	3.75	3.75	-9.0	0.92	na
South Africa	-7.4 Mar	-21.0 Q4	-5.5	8.47	7.52	-4.0	8.03	8.55
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	-3.2 Feb	-1.8 Feb	-3.0	11.8	10.2	-3.5	6.27	na
Finland	+8.0 Feb	+3.4 Feb	+0.6	0.75	0.65	-4.1	1.33	3.79
Iceland	+0.2 Apr	-5.6 Q4	+0.4	126	76.8	-10.5	13.13	na
Ireland	+45.0 Feb	-12.7 Q4	-2.5	0.75	0.65	-12.0	1.33	5.12
Latvia	-5.2 Feb	-3.5 Feb	-4.0	0.53	0.45	-6.0	11.06	na
Lithuania	-6.1 Feb	-5.1 Feb	-3.0	2.60	2.24	-3.5	6.84	na
Luxembourg	-7.8 Jan	+3.0 Q4	na	0.75	0.65	-4.5	1.33	na
New Zealand	-3.3 Mar	-11.3 Q4	-6.7	1.72	1.28	-6.3	4.05	5.53
Peru	+2.2 Feb	-4.2 Q4	-5.9	2.96	2.78	-1.8	5.00	na
Philippines	-7.8 Feb	+4.2 Dec	+2.0	47.8	42.4	-2.7	4.06	na
Portugal	-33.8 Jan	-27.7 Feb	-9.7	0.75	0.65	-4.9	1.33	4.16
Slovakia	-1.2 Feb	-7.1 Feb	-6.2	22.7	20.8	-4.0	1.35	4.61
Slovenia	-4.3 Feb	-2.6 Jan	-1.6	0.75	0.65	-3.8	1.33	na
Ukraine	-16.9 Q4	-10.1 Q1	-2.2	7.98	4.80	-4.0	16.00	na
Vietnam	-8.2 Mar	-7.0 2007	-1.8	17,784	16,146	-8.2	8.01	8.05

*Merchandise trade only. †The Economist poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

May 7th 2009
From The Economist print edition

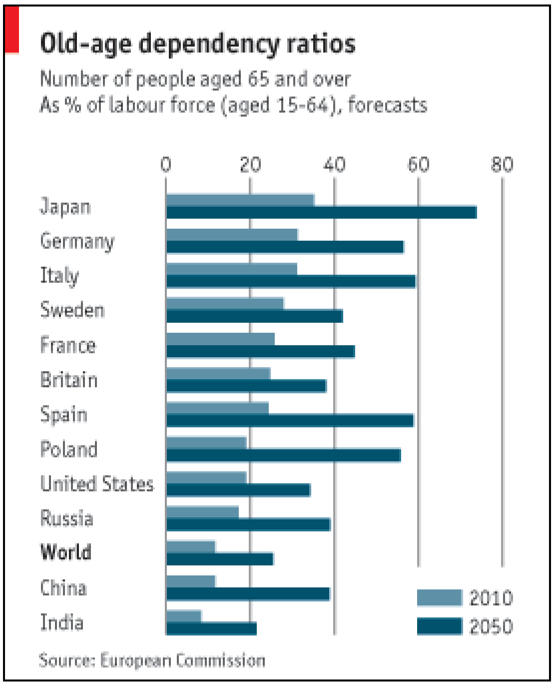
Markets

	Index May 6th	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	8,512.3	+4.0	-3.0	-3.0
United States (S&P 500)	919.5	+5.3	+1.8	+1.8
United States (NAScomp)	1,759.1	+2.8	+11.5	+11.5
Japan (Nikkei 225)	8,977.4	+5.7	+1.3	-7.0
Japan (Topix)	846.9	+4.3	-1.4	-9.5
China (SSEA)	2,721.4	+5.0	+42.3	+42.4
China (SSEB, $ terms)	168.6	+5.0	+52.0	+52.0
Britain (FTSE 100)	4,396.5	+4.9	-0.8	+3.8
Canada (S&P TSX)	10,143.4	+7.7	+12.9	+18.5
Euro area (FTSE Euro 100)	753.8	+4.6	+1.0	-3.4
Euro area (DJ STOXX 50)	2,437.3	+4.4	-0.4	-4.7
Austria (ATX)	2,018.5	+11.1	+15.3	+10.3
Belgium (Bel 20)	2,024.9	+3.8	+6.1	+1.5
France (CAC 40)	3,283.5	+5.3	+2.0	-2.4
Germany (DAX)*	4,880.7	+3.7	+1.5	-2.9
Greece (Athex Comp)	2,191.2	+10.1	+22.7	+17.4
Italy (S&P/MIB)	20,104.0	+6.3	+3.3	-1.2
Netherlands (AEX)	255.3	+7.2	+3.8	-0.7
Spain (Madrid SE)	956.8	+3.8	-2.0	-6.2
Czech Republic (PX)	951.8	+12.3	+10.9	+6.4
Denmark (OMXCB)	273.4	+10.7	+20.9	+15.6
Hungary (BUX)	13,809.3	+7.2	+12.8	+1.0
Norway (OSEAX)	315.3	+6.9	+16.7	+25.1
Poland (WIG)	29,887.3	+5.7	+9.8	-1.6
Russia (RTS, $ terms)	897.1	+10.1	+52.7	+42.0
Sweden (OMXS30)†	799.4	+4.0	+20.7	+20.4
Switzerland (SMI)	5,319.3	+3.2	-3.9	-9.8
Turkey (ISE)	33,716.9	+9.7	+25.5	+23.6
Australia (All Ord.)	3,840.1	+4.9	+4.9	+11.2
Hong Kong (Hang Seng)	16,834.6	+12.6	+17.0	+17.0
India (BSE)	11,952.8	+4.8	+23.9	+21.7
Indonesia (JSX)	1,798.3	+9.4	+32.7	+38.9
Malaysia (KLSE)	1,024.0	+5.8	+16.8	+14.4
Pakistan (KSE)	7,198.9	-1.0	+22.7	+20.6
Singapore (STI)	2,179.0	+17.8	+23.7	+21.0
South Korea (KOSPI)	1,393.5	+4.1	+23.9	+22.2
Taiwan (TWI)	6,566.7	+17.0	+43.0	+41.5
Thailand (SET)	523.1	+8.2	+16.3	+15.0
Argentina (MERV)	1,409.9	+11.0	+30.6	+21.8
Brazil (BVSP)	51,499.0	+9.0	+37.1	+50.7
Chile (IGPA)	13,319.0	+3.0	+17.6	+30.9
Colombia (IGBC)	8,574.2	+2.5	+13.4	+14.3
Mexico (IPC)	23,906.1	+8.3	+6.8	+11.7
Venezuela (IBC)	44,030.4	-0.7	+25.5	+35.1
Egypt (Case 30)	5,332.9	+4.8	+16.0	+13.6
Israel (TA-100)	768.5	+5.5	+36.2	+24.1
Saudi Arabia (Tadawul)	5,802.1	+3.1	+20.8	+20.9
South Africa (JSE AS)	21,783.4	+6.4	+1.3	+10.6
Europe (FTSEurofirst 300)	858.6	+5.2	+3.2	-1.3
World, dev'd (MSCI)	934.8	+5.5	+1.6	+1.6
Emerging markets (MSCI)	712.1	+10.3	+25.6	+25.6
World, all (MSCI)	236.5	+6.0	+3.9	+3.9
World bonds (Citigroup)	772.6	-0.3	-4.6	-4.6
EMBI+ (JPMorgan)	434.8	+3.6	+11.0	+11.0
Hedge funds (HFRX)§	1,050.5	+1.0	+2.9	+2.9
Volatility, US (VIX)	32.5	36.1	40.0	(levels)
CDSs, Eur (iTRAXX)‡	146.4	-15.2	-27.6	-30.7
CDSs, N Am (CDX)‡	200.4	-12.7	-14.1	-14.1
Carbon trading (EU ETS) €	14.6	+6.4	-9.6	-13.5

*Total return index. †New series. ‡Credit-default swap spreads, basis points. Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. §May 5th

Old-age dependency ratios

May 7th 2009
From The Economist print edition



Continued increases in longevity will ensure that the old-age dependency ratio, which measures the number of elderly people as a share of those of working age, will rise sharply in most countries over the next 40 years, according to the European Commission. The biggest absolute increase will be in Japan, where the ratio of 35.1% in 2010, already the world's highest, will more than double, to 73.8%, by 2050. At that point, the number of pensioners in China will be equivalent to 38.8% of its labour force, up from 11.6% in 2010. The European Union, which had 84.6m elderly people last year, will have 148.4m in 2050. And the ratio for the world as a whole will reach 25.4%, up from 11.7% in 2010.